Explanatory Notes to a Bill Amending the Income Tax Act

Issued by
The Honourable Marc Lalonde
Minister of Finance

December 1982

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The explanatory notes are provided to assist in an understanding of the amendments proposed to the Income Tax Act. They are intended for informational purposes only and should not be construed as an official interpretation of the provisions they describe.

Preface

This publication arises out of a recognition of the problems posed by the complex nature of income tax legislation. Its purpose is to assist Members of Parliament and other interested Canadians in understanding the changes to the Income Tax Act now being proposed. These changes relate to the budgets of November 12, 1981, June 28, 1982 and my Economic Statement of October 27, 1982. This material provides an explanation of the Bill on a clause-by-clause basis. It describes the intent of each amendment with particular reference to the technical aspects of the changes.

The value of publishing explanatory materials such as those provided by this paper is widely recognized. The Canadian Tax Foundation and other groups concerned by the increasing complexity of income tax legislation have recommended that proposed tax changes be accompanied by explanatory material. In the paper tabled earlier this year entitled "The Budget Process", the benefits of providing a technical explanation of tax legislation were noted in these words:

> "The tax legislative process would also be enhanced if tax legislation were accompanied by technical explanations that would facilitate an understanding of each provision. Given the complexity of many of the provisions, this would aid the review of legislation both by the public and by Parliament."

It is hoped that this paper goes some way in improving the income tax legislative process and in making Canadian income tax legislation more understandable for Canadians.

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Inclusions in Income from Employment

Clause 1

Subclause 1(1)

ITA 6(1)(a)(iii)

Paragraph 6(1)(a) of the Act deals with the taxation of benefits from employment. This amendment adds subparagraph 6(1)(a)(iii) to provide an exception for any benefits relating to the availability of an automobile for personal use, but clarifies that the operating costs of an automobile used for personal purposes which are paid by the employer must be included in income. The benefit resulting from the availability of an automobile for personal use, which is generally referred to as an automobile standby charge, is dealt with separately in paragraph 6(1)(e) and subsection 6(2) of the Act. This amendment applies to the 1982 and subsequent taxation years.

Subclause 1(2)

ITA 6(1)(e)

Where an employer makes an automobile available for the personal use of an employee, a standby charge must be included in the employee's income. The scope of paragraph 6(1)(e) of the Act is expanded to require an income inclusion when an automobile is made available by a person related to an employer or is made available to a person related to the employee. The amendment also clarifies that the reduction in the standby charge for any amounts paid by the employee to his employer for the use of the automobile does not apply to amounts paid by the employee to reimburse the employer for operating expenses. Corresponding amendments to section 15 of the Act relating to the standby charge imposed where a corporation makes an automobile available to a shareholder are also being made in this Bill. These amendments apply to the 1982 and subsequent taxation years.

Subclause 1(3)

ITA 6(2)

Subsection 6(2) of the Act provides the rules for calculating the automobile standby charge. This amendment to subsection 6(2) increases the amount of the monthly benefit, in the case of an automobile owned by an employer, to 2% of the cost of the automobile and, in the case of an automobile leased by an employer, to two-thirds of the leasing cost. The amount of the annual standby charge is reduced where the employee establishes that the automobile was driven for personal use in a year for less than 12,000 kilometres (or 1,000 kilometres for each month the automobile is made available). This amendment applies to the 1982 and subsequent taxation years.

Subclause 1(4)

ITA 6(2.1)

Subsection 6(2.1) of the Act sets out the special rules for determining the standby charge for automobile salesmen. The basis on which the charge is calculated recognizes that such salesmen will ordinarily use a number of automobiles in the course of a year. This amendment to subsection 6(2.1) of the Act is consequential on the increase in the standby charge in subsection 6(2) and maintains the rate for automobile salesmen at 75% of the rate for other employees. This amendment applies to the 1982 and subsequent taxation years.

Subclause 1(5)

ITA
6(6)(a)(i)

An employee may exclude from income the value of transportation to and from, and board and lodging at, a special work site in connection with temporary employment away from his ordinary place of residence. This amendment to subparagraph 6(6)(a)(i) removes the requirement that, to qualify for the exclusion, the employee must support a spouse or other dependant at his ordinary place of residence. This amendment applies to the 1981 and subsequent taxation years.

Subclause 1(6)

ITA
6(9)

Subsection 6(9) of the Act requires the benefit arising on loans extended to employees at preferential interest rates to be included in employment income. The amendment to this subsection is consequential on the amendments to section 80.4 of the Act relating to employee loans. The amendment is applicable after 1981.

Subclauses 1(7), (8) and (9)

These set out the effective dates for the amendments to section 6 of the Act.

Deductions from Income from Employment

Clause 2

Subclause 2(1)

ITA 8(1)(n)

Section 8 of the Act provides for certain deductions in determining employment income. This amendment adds a new paragraph 8(1)(n) to permit an employee a deduction where amounts received from an employer for a period throughout which he did not perform the duties of his office or employment are subsequently repaid by him. This would apply, for example, where an employee receives his ordinary remuneration during a period of sickness or disability but is required to reimburse his employer out of any proceeds he may receive under an insurance policy or workmen's compensation plan The deduction is limited to the total amounts received by him for such period that were included in his employment income. This amendment applies to the 1981 and subsequent taxation years.

Subclause 2(2)

ITA 8(3)(a.1)

Subsection 8(3) of the Act denies the 3% employment deduction in the case of certain employees such as salesmen who deduct expenses under paragraph 8(1)(f) and members of the Senate and House of Commons of Canada, and restricts the deduction in the case of elected members of a provincial legislative assembly and elected municipal officers. New paragraph 8(3)(a.1) adds an employee, who is an incorporated employee and a specified shareholder of a corporation that has deducted an amount under subparagraph 18(1)(p)(iii) (expenses relating to the selling of property or negotiating of contracts), to the list of persons ineligible for the 3% employment deduction. If paid directly by the employee, such expenses would be deductible under paragraph 8(1)(f), and paragraph 8(1)(a) would prohibit a deduction.

This amendment applies to the 1981 and subsequent taxation years.

Subclause 2(3)

This sets out the effective date for the amendments to section 8 of the Act.

Inventory Rules for Work in Progress

Clause 3

In computing income from a professional business, taxpayers have been permitted to elect under section 34 of the Act to exclude work in progress. Section 34 is amended to restrict its application to certain named professions, and section 10 of the Act is amended to provide rules for valuing inventory where work in progress must be included in computing the income of a professional business.

Subclause 3(1)

ITA
10(4)

Where work in progress is required to be valued each year end, it is to be valued in the same way as other inventory, generally at the lower of its cost and fair market value. The amendment to subsection 10(4) of the Act provides that, for this purpose, the fair market value of work in progress of a professional business is the amount that can reasonably be expected to become receivable in respect thereof.

Subclause 3(2)

ITA
10(5)

New subsection 10(5) of the Act specifies that work in progress of a professional business is to be treated as inventory. A related amendment is made to the definition of "property" in subsection 248(1) of the Act.

Subclause 3(3)

ITA
10(6)

Subsection 10(6) of the Act provides a two-year transitional rule for professional work in progress. The cost and fair market-value of professional work in progress at the end of the 1982 taxation year is deemed to be nil, and at the end of the 1983 taxation year will be only one-half of the amount that would otherwise be required. For 1984 the full amount in respect of work in progress must be included in computing income from a professional business. This transitional relief is only available to a taxpayer who elected to exclude professional work in progress in computing income for his 1982 taxation year.

Subclause 3(4)

This sets out the effective dates for the amendments to section 10 of the Act.

Inclusions in Income from Business or Property

Clause 4

Subclause 4(1)

ITA 12(1)(b)

Paragraph 12(1)(b) of the Act requires any amount receivable in respect of property sold or services rendered in the course of a business in a year to be included in that year's income. This paragraph is amended to add a provision that treats an amount as having become receivable for services performed on the day the account would have been rendered had there been no undue delay in rendering the account for the services. This rule, which previously applied only to services rendered in the course of a professional business under section 34 of the Act, has been expanded to apply to all services. This amendment applies to taxation years ending after 1982.

ITA 12(1)(c)

Paragraph 12(1)(c) of the Act requires interest received or receivable in the year to be included in income. This amendment ensures that any accrued interest included in income in a preceding taxation year will not be included in income in a subsequent year when it is received or becomes receivable. The amendment is consequential on the various provisions of the Act that require accrued interest to be included in income in certain circumstances. This amendment is applicable to the 1982 and subsequent taxation years.

Subclause 4(2)

ITA 12(1)(e)(i)

Subparagraph 12(1)(e)(i) of the Act is amended to include in income in a taxation year the amount of any manufacturer's extended warranty reserve deducted in the preceding taxation year under new paragraph 20(1)(m.1) of the Act. The amendment applies to the 1979 and subsequent taxation years.

Subclause 4(3)

ITA 12(1)(n.1)

Many employee benefit plans governed by a trust provide for the payment to the employer of any income earned in the plan that is not paid out to employees. This enables the trust to avoid double taxation on the income—once when the income is earned, and later when it is distributed to employees. The employer should include in its income the distribution it received from the trust and increase the amount of its contribution to the trust for the year in order to meet its obligations to employees. Under the existing law, the amount deductible by the employer in respect of its contributions is reduced by any income received by it out of the trust. This is inappropriate since the employer should not receive any deduction (or offset any item of income) until the employee reports as income amounts paid to him by the trust out of the employer's contributions. This amendment corrects this defect in the law. By requiring amounts received by an employer out of the income of an employee benefit plan to be included in income rather than to be offset against future deductions, the section will effectively be restricted to returns of employer contributions—that is, excess contributions. A corresponding amendment has been made to subsection 104(13) of the Act.

This amendment, which corrects a technical defect in the law, is retroactive to the 1980 taxation year when the rules relating to employee benefit plans were introduced.

Subclause 4(4)

ITA 12(1)(o)(v)

Paragraph 12(1)(o) of the Act requires a taxpayer to include in income amounts which became receivable in the year by the Crown in respect of production from a resource property in which the taxpayer had an interest. This paragraph applies when the federal or a provincial government has an interest in production from a mineral resource or an oil or gas well.

Paragraph 18(1)(m) deals with the payment to the Crown of royalties or taxes related to the production from, or ownership of, a mineral resource or an oil or gas well.

Subparagraph (v) of paragraph 12(1)(o) identifies the oil and gas and mineral resource interests which are subject to this rule. Subparagraph (v) is amended to clarify that it applies to all interests and to exclude from paragraph 12(1)(o) amounts in respect of the production of a mineral by-product (for example, sulphur) from an oil or gas well. This amendment applies to taxation years commencing after 1982. A corresponding amendment is made to paragraph 18(1)(m) of the Act.

Subclause 4(5)

ITA 12(1)(t)

The amount deducted from tax in respect of the investment tax credit reduces the tax basis of the relevant expenditure—that is, the undepreciated capital cost of depreciable property or the amount of deductible scientific research expenses. To the extent such reductions in tax basis do not take place, paragraph 12(1)(t) includes the investment tax credit in the taxpayer's income. Paragraph 12(1)(t) is amended to reflect the introduction of subparagraphs 53(2)(c)(vi) and (h)(ii) of the Act. These new subparagraphs reduce the adjusted cost base of a partnership interest and certain trust interests by the portion of the investment tax credit that is flowed through and claimed by members of the partnership or beneficiaries of the trust. The amendment to paragraph 12(1)(t) ensures that the credit is not included in income where it has reduced the tax basis of the taxpayer's interest in the partnership or trust, as the case may be. This amendment applies to the 1982 and subsequent taxation years.

Subclause 4(6)

ITA 12(1)(w)

This amendment adds paragraph (w) to subsection 12(1) of the Act to ensure that the benefit associated with indebtedness with a preferential interest rate that is extended to a corporation carrying on a personal services business will be included in its income. This applies only to benefits on indebtedness dealt with in section 80.4 of the Act—that is, to those benefits that would be required to be included in income if the corporation were an employee. Paragraph 12(1)(w) of the Act thus complements subsection 6(9) of the Act which requires an employee to include a benefit on certain employer loans as provided in section 80.4 of the Act. This amendment applies to taxation years commencing after November 12, 1981.

Subclauses 4(7) and (8)

ITA
12(3) to (6) and
(8) to (11)

Subsections 12(3) to (6) of the Act were added, effective October 28, 1980, to require all corporations and partnerships and certain trusts to include interest in income on an accrual basis. These subsections are extensively amended and subsections 12(8) to (11) are added to incorporate new rules relating to accrued interest for taxpayers other than corporations, partnerships and certain trusts. Subsection 12(4) which previously related to annuity contracts has been revised and the rules requiring the accrual of income on annuities and life insurance policies are now contained in section 12.2 of the Act.

ITA
12(3)

Subsection 12(3) is amended to restrict its application to accrued interest on debt obligations. In addition, interest on a small business development bond or a small business bond is excluded from subsection 12(3) because such interest is deemed to be a dividend for purposes of the Act. These amendments apply to taxation years commencing after 1982.

ITA
12(4)

Subsection 12(3) of the Act applies only to corporations, partnerships and certain trusts. New subsection 12(4) extends to individuals the requirement to report accrued income on certain debt obligations. An individual is required to include in income interest that has accrued in respect of an "investment contract" (as defined in paragraph 12(11)(a) of the Act) to the extent that such interest was not previously included in computing income. This will apply only to interest which has accrued after December 31, 1981. The accrued interest must be reported every third year unless the taxpayer has elected to report it on an annual basis. Annual accrual may be advantageous for some individuals who have not fully utilized the $1,000 exclusion for investment income. The new subsection 12(4) applies to taxation years commencing after 1982.

ITA
12(5)

Subsection 12(5) of the Act previously excluded from the accrued interest rules interest on a debt obligation acquired before October 29, 1980 in certain circumstances. Subsection 12(5) is amended to limit the exclusion for such obligations to taxation years ending before December 31, 1984. The exclusion for such obligations will continue with respect to interest accrued before the beginning of the first taxation year commencing after November 12, 1981. Thus, for taxation years ending on or after December 31, 1984, the accrual rules will generally apply to all debt obligations except with respect to interest accrued before the beginning of the taxpayer's first taxation year commencing after November 12, 1981. The amendment to subsection 12(5) applies to taxation years commencing after 1982.

ITA
12(6)

Subsection 12(6) of the Act is amended so that the accrued interest rules in subsection 12(3) will not apply to a debt obligation acquired before October

29, 1980 from an arm's length issuer where the taxpayer or partnership is effectively "locked into" the obligation—that is, where the debtor cannot after October 28, 1980 require the repayment, acquisition, cancellation or conversion of the debt obligation. This grandfather status for debt obligations outstanding on October 28, 1980 will be lost if, after that date, its maturity date is extended or the terms and conditions relating to payments under the obligation are changed. The amendment to subsection 12(6) applies to taxation years commencing after 1982.

ITA
12(8)

The election to permit an individual to report accrued interest on an "investment contract" on an annual basis is provided in subsection 12(8) of the Act. The election takes the form of a written notification to the issuer of the investment contract. The election to substitute annual accrual for three-year accrual applies to the particular contract for the taxation year in which the issuer is notified and all subsequent years. Subsection 12(8) applies to taxation years commencing after 1982.

ITA
12(9)

Subsection 12(9) of the Act authorizes special rules to be provided in the Income Tax Regulations for determining accrued interest income on prescribed debt obligations. (See subsection 6900(1) of the draft regulations which define a prescribed debt obligation to include deep discount bonds and bonds where interest coupons are sold separately from the principal.) The special rules to be provided in the Income Tax Regulations (see subsections 6900(2) and (3) of the draft regulations) will apply for purposes of subsections 12(3), (4), (8) and (11) and 20(14) of the Act to determine the interest to be accrued on prescribed debt obligations. Subsection 12(9) applies to taxation years commencing after 1981.

ITA
12(10)

Subsection 12(10) of the Act provides what is generally referred to as "grandfather protection" for investment contracts acquired before November 13, 1981. The new accrued interest rule in subsection 12(4) will not apply to a grandfathered investment contract where the taxpayer is "locked into" such contract—that is, where he cannot require at any time after November 12, 1981 its repayment, acquisition, cancellation or conversion (otherwise than by reason of default) under the terms thereof. This grandfather protection will be lost if the maturity date is extended or the terms or conditions relating to payments are changed after November 12, 1981.

ITA
12(11)(a)

Paragraph 12(11)(a) of the Act defines "investment contract". It means any debt obligation but does not include an income bond or debenture, a small business development bond or a small business bond. Also excluded is any debt obligation in respect of which the taxpayer has always reported accrued interest income at periodic intervals of less than three years. In these circumstances, the election provided under subsection 12(8) is unnecessary. The election is necessary, however, where a taxpayer commenced reporting accrued interest on an investment contract every three years and later decided to report the accrued interest on an annual basis. Paragraph 12(11)(a) applies to taxation years commencing after 1981.

ITA
12(11)(b)

Paragraph 12(11)(b) of the Act provides that for the purpose of the three-year accrual rule, the third anniversary of an investment contract is three years after December 31st of the year in which the contract is issued and every third December 31st thereafter. For example, the third anniversary of an investment contract issued at any time in 1982 will first occur on December 31, 1985, next on December 31, 1988, and so on. On a contract acquired before 1982, its issue date is deemed to be December 31, 1984. Thus, the third anniversary for such a contract will first occur in 1987. Paragraph 12(11)(b) applies to taxation years commencing after 1981.

Subclauses 4(9) to 4(15)

These set out the effective dates for the amendments to section 12.

Accrued Income on Life Insurance Policies and Annuities

Clause 5

The rules relating to the accrual of income on certain life insurance policies and annuities are set out in the new section 12.2 of the Act.

ITA 12.2(1)

Subsections 12.2(1) and (2) of the Act provide the accrual rules with respect to annuities and life insurance policies held by a corporation, partnership, unit trust or any other trust which has a corporation or a partnership as a beneficiary. These entities were previously required to accrue annuity income under subsection 12(3) of the Act. The requirements relating to accruals by other taxpayers, including individuals, on annuities and life insurance policies are set out in subsections 12.2(3) and (4) of the Act.

Corporations and other entities described in subsection 12.2(1) of the Act are required to accrue income on an annual basis. Accrual will be required on any life insurance policy, other than an exempt policy, acquired after December 1, 1982. The expression "exempt policy" is to be defined in section 307 of the Income Tax Regulations. Accrual is also required under subsection 12.2(1) on any annuity contract acquired after December 1, 1982 and on those annuity contracts acquired after December 19, 1980 and before December 2, 1982 in those circumstances where payments by the issuer under the contracts had not commenced before December 2, 1982. The rules will not apply to an immediate level-payment annuity contract derived from a life insurance policy acquired before December 2, 1982.

The amount accruing each year under a life insurance policy or an annuity is the amount by which the accumulating fund exceeds the adjusted cost basis of the policy or annuity at the end of the calendar year. The expression "accumulating fund" is to be defined in section 308 of the Income Tax Regulations. In general terms, it means the greater of the cash surrender value of the policy and the excess of the present value of its future benefits over the present value of future premiums.

Accrual under subsection 12.2(1) of the Act applies for taxation years commencing after 1982.

ITA 12.2(2)

Subsection 12.2(2) of the Act sets out the rules with respect to annuity contracts acquired before December 20, 1980. For those contracts subject to the accrual rules (such as an annuity, where payments have not commenced before December 2, 1982) the income accrued for the period from January 1, 1982 to December 31, 1984 is required to be included in the corporation's first taxation year ending after December 30, 1984. Thereafter, the income earned on the annuity will be accrued annually. Under paragraph 12.2(2)(b) the income accrued before January 1, 1982 will be required to be included in income over a period of years. In the case of a term-certain annuity, the pre-1982 income will be brought into income over the period beginning when payments commence and ending at the termination of the contract. In the case of a life annuity, the pre-1982 income will be brought into income after the payments commence and over the period the payments are expected to be made.

ITA
12.2(3)

Subsection 12.2(3) of the Act sets out the accrual rules with respect to annuities and life insurance policies for individuals and those trusts to which subsection 12.2(1) does not apply. This subsection requires the accrual of income every three years—that is, at the end of each year in which a third anniversary of the contract or policy occurs. The definition "third anniversary" is provided in paragraph 12.2(10)(c) of the Act.

The accrual rules in subsection 12.2(3) apply to life insurance policies and annuities acquired after December 1, 1982 and to annuity contracts acquired before December 2, 1982 provided that annuity payments have not started before that date. The first "third anniversary" of an annuity acquired before December 2, 1982 and on which annuity payments have not commenced before that date is December 31, 1987. The first year in which income will be required to be included under subsection 12.2(3) for life insurance policies and annuities issued in December 1982 will be 1985.

Certain life insurance policies and annuities are exempt from the three-year accrual under subsection 12.2(3) of the Act. These include exempt policies, prescribed annuity contracts and annuity contracts which derive from life insurance policies acquired before December 2, 1982. The expression "exempt policy" is to be defined in section 307 of the Income Tax Regulations. In general terms, an exempt policy is a life insurance policy which requires premiums to be paid over at least a 20-year period and certain other restrictions to be met with regard to such matters as the rate of increase in the death benefit. The expression "prescribed annuity contract" is to be defined in section 305 of the Income Tax Regulations. In general terms, it means an annuity contract held by a person who is 60 years of age or older, in respect of which the holder has made an election and under which the payments after the election are to be made in equal amounts on an annual basis or more frequently.

The amount of the accrued income in respect of a life insurance policy or an annuity in a year in which its third anniversary occurs is the amount by which its accumulating fund exceeds its adjusted cost basis at the end of the year. Where the annuity is one on which payments have commenced, an additional amount in respect of any unallocated pre-1982 income will be required to be included in income in each third anniversary year. The rules with respect to unallocated pre-1982 income are described in the commentary on subsection 12.2(2) of the Act.

Accrual under subsection 12.2(3) of the Act applies for taxation years commencing after 1982.

ITA
12.2(4)

Subsection 12.2(4) of the Act permits a taxpayer to elect to be taxed on an annual accrual basis with respect to a life insurance policy to which the accrual rules apply or an annuity contract under which payments have not commenced. This election permits an individual to take full advantage of the $1,000 annual investment income deduction. The election is made by the taxpayer by providing written notice to the issuer of the policy or contract, as the case may be. The computation of the accrued income on an annual basis is similar to the computation for corporations under subsection 12.2(1) of the Act.

ITA
12.2(5)

Subsection 12.2(5) of the Act provides that where the adjusted cost basis of an annuity contract as determined under paragraph 148(9)(a) of the Act becomes negative, the negative amount is required to be included in income. This is necessary to ensure that income accrued in the last year of a term-certain annuity is included in income.

ITA
12.2(6) and (7)

Subsections 12.2(6) and (7) of the Act provide an exception from the accrual rules for certain pre-accrual locked-in deferred annuity contracts. In addition, there is a further exception for any pre-accrual annuity contract until such time as the cash surrender value of the contract exceeds the premiums paid thereon. For corporations, partnerships, unit trusts, or trusts which have corporations or partnerships as their beneficiaries, these exceptions apply if the annuity contract was acquired on or before December 19, 1980, and for other taxpayers if the contract was acquired on or before December 1, 1982.

ITA
12.2(8)

Subsection 12.2(8) of the Act provides that an annuity contract acquired on or before December 1, 1982, which would otherwise be exempt from the accrual rules, will be subject to accrual to the extent that any premiums paid after that date were not fixed on that date. The unfixed portion of such premiums will be treated as having been paid under a separate annuity contract after December 1, 1982 on which accrual will be required.

ITA
12.2(9)

Subsection 12.2(9) of the Act provides a rule with respect to life insurance policies similar to that in subsection 12.2(8) with respect to annuities. Any life insurance policy that would otherwise be subject to the pre-December 2, 1982 rules for life insurance policies will be treated as a policy acquired after December 1, 1982 if, after that date, a premium is paid under the policy which was not fixed on or before that date.

ITA
12.2(10)

Subsection 12.2(10) of the Act sets out the definitions of "exempt policy", "third anniversary" and "paid-up addition". The definition of exempt policy is to be provided in section 307 of the Income Tax Regulations. Both this definition and the definition "third anniversary" are explained in the commentary on subsections 12.2(1) and (3) of the Act. A "paid-up addition" is defined as an increase in life insurance coverage or annuity benefit which has been granted in satisfaction of a policy dividend. This definition is relevant for the purpose of new subsection 12.2(9) of the Act.

Clause 6

Subclause 6(1)

ITA
13(5.4) and (5.5)

Subsection 13(5.2) of the Act applies where a taxpayer has paid rent for property such as a building and later acquires the property. In these circumstances, subject to certain limitations, the rent is "recaptured" if the property is subsequently sold for a profit. This is achieved by treating the rental payments as depreciation so that on disposal of the property the rules that require the depreciation recapture to be included in income, will apply.

Subsection 13(5.4) of the Act ensures similar treatment where a taxpayer acquires property and subsequently incurs an expense (such as rent) for the use of the property. This may occur on a lease-leaseback transaction—for example, where land owned by a taxpayer is leased to a developer who constructs a building thereon and leases it back to the taxpayer. The taxpayer would pay rent for the use of the property throughout the term of the lease. Under subsection 13(5.4) the rental payments will, within certain limits, be added to the capital cost of the property and be deemed to have been claimed previously as depreciation. Therefore, on subsequent disposition of the property at a profit, the rental payments may be included in income as depreciation recapture. Amounts paid or payable to a non-arm's length person are not subject to these rules.

Subsection 13(5.5) of the Act provides that a lease cancellation payment deductible under paragraph 20(1)(z) or (z.1) of the Act is deemed not to be a rental payment for the purpose of the rules provided in subsection 13(5.4) of the Act. The provisions relating to lease cancellation payments are contained in paragraphs 18(1)(q) and 20(1)(z) and (z.1) of the Act.

These amendments apply to property owned by a taxpayer after November 12, 1981.

Subclause 6(2)

ITA
13(21.1)

Generally, when depreciable property of a prescribed class is disposed of, the proceeds of disposition reduce the undepreciated capital cost of that class. If the proceeds exceed the undepreciated capital cost of a class, the excess, referred to as recaptured depreciation, must be included in income. If the proceeds are less than the undepreciated capital cost of a class and the property is the last remaining property in the class, the balance, referred to as a terminal loss, is deductible. Subsection 13(21.1) is added to the Act to provide rules to allocate proceeds of disposition between land and buildings on the sale of real estate.

Subsection 13(21.1) applies where a building is sold at a loss. This occurs where the proceeds of disposition of a building are less than its cost amount—that is, its proportionate share of the undepreciated capital cost of the building class. In the typical case, where the land on which the building is situated was also disposed of at the same time, the loss on the sale of the building will be reduced to the extent of any gain on the sale of the land. Technically this is achieved by increasing the amount that is treated as proceeds on the disposition of the building by the lesser of the amount of the loss and the gain on the sale of the land. Where this occurs, the capital gain on the sale of the land will be reduced by a corresponding amount. The result is that, in effect, the loss on the building is offset by the gain on the land.

Where the land on which the building is situated is not disposed of in the same year and was owned at any time before the disposition of the building by the taxpayer or by a related person, different rules apply. In this case, the amount treated as proceeds of disposition of the building for purposes of determining the remaining undepreciated capital cost of the class (or the terminal loss if the building is the last property in the class) will be the actual proceeds plus one-half of the difference between the cost amount of the building (or its fair market value, if greater) and the actual proceeds. The effect of this rule is to treat the loss on the sale of a building as a capital loss, only one-half of which is deductible, rather than as an ordinary loss.

The rules in this subsection have no application where the land and building have always been owned by different persons who are not related.

Subsection 13(21.1) of the Act applies to dispositions occurring after November 12, 1981, other than dispositions occurring pursuant to the terms of a written agreement entered into on or before that date.

Subclauses 6(3) and (4)

These set out the effective dates for the amendments to section 13 of the Act.

Shareholder Benefits

Clause 7

Subclause 7(1)

ITA
15(2)

Subsection 15(2) of the existing Act requires certain loans by a corporation to be included in the debtor's income. This amendment broadens the scope of this subsection to cover not only loans, but also other forms of indebtedness. Subsection 15(2) at present applies where the loan is to a person who is a shareholder of a corporation or a person who does not deal at arm's length with the shareholder. A further amendment to subsection 15(2) clarifies that it applies in certain circumstances where the debtor is a partnership, a member of a partnership or a beneficiary of a trust. These amendments apply to loans made and indebtedness incurred after 1981.

A consequential amendment is made to paragraph 20(1)(j) of the Act relating to the tax treatment of repayments of indebtedness to which the rules in subsection 15(2) had previously applied.

Subclauses 7(2) and (3)

ITA
15(5) and (6)

Subsections 15(5) and (6) of the existing Act establish the value of the benefit to a shareholder where an automobile is made available by the corporation for his personal use. The amendments to these subsections ensure that the benefit to be included in the shareholder's income is generally determined on the same basis as it is determined under section 6 of the Act for employees who use an employer-provided automobile for their own use. Where the shareholder is also an employee, the benefit will be included in income under section 6 as income from employment rather than under section 15 as an advantage conferred on a shareholder.

Subclause 7(4)

ITA
15(7) and (8)

Subsection 15(7) of the Act confirms that the rules relating to shareholder loans and other shareholder benefits are applicable whether or not the corporation or lender is resident or carries on business in Canada. Subsection 15(8) of the Act provides that the rules in subsection 15(2) relating to shareholder indebtedness do not apply to indebtedness between non-residents. The amendments to subsections 15(7) and (8) are strictly consequential on the amendments to subsection 15(2) which extend the rules for shareholder loans to other forms of indebtedness and which clarify their application to certain partnerships, members of partnerships and beneficiaries of trusts.

ITA
15(9)

There are a number of amendments to section 80.4 of the Act relating to indebtedness between an employer and an employee or between a corporation and a shareholder on which interest is not payable or is less than the normal market rate. The amendments to subsection 15(9) are consequential on the amendments to section 80.4. In addition, the amendment clarifies that if the shareholder is also an employee, the benefit under section 80.4 will be included as income from employment rather than as a shareholder benefit.

The amendment to subsection 15(8) applies to loans made and indebtedness incurred after 1981. The amendment to subsection 15(9) is applicable to the 1982 and subsequent taxation years.

Subclauses 7(5) and (6)

These set out the effective dates for the amendments to section 15 of the Act.

Clause 8

ITA 15.1

Section 15.1 of the Act contains the provisions relating to small business development bonds. Interest on such bonds is not deductible by the issuer but is instead treated as a taxable dividend to the recipient. There are a number of amendments to this section including the extension of the measure for an additional two-year period to cover bonds issued before 1984.

Subclause 8(1)

ITA 15.1(2)(d)(iii)

To avoid an addition to taxable income, the issuer of a small business development bond must use the proceeds during the term of the bond for the intended purpose. The amendment to subparagraph 15.1(2)(d)(iii) of the Act requires that the proceeds of a small business development bond issued by a corporation in financial difficulty must be used to finance an active business carried on in Canada. This amendment is applicable to bonds issued after 1981.

Subclause 8(2)

ITA 15.1(3)(a)

Paragraph 15.1(3)(a) of the Act provides a definition of "eligible small business corporation"—that is, one that may issue a bond that qualifies as a small business development bond. An eligible corporation is one whose income in the year is subject to the low rate of tax, that is, the small business deduction under section 125 of the Act. The amendment to this paragraph is strictly consequential on the increase in the total amount eligible for the small business deduction from $750,000 to $1,000,000.

Subclauses 8(3) and (4)

ITA 15.1(3)(b)

Paragraph 15.1(3)(b) of the Act defines a "qualifying debt obligation". The amendment extends to the end of 1983 the deadline for issuing an obligation that will qualify as a small business development bond where the issuing corporation is in financial difficulty. The definition of qualifying debt obligation is also amended to extend until January 31, 1982 the deadline for acquiring specified property and financing qualified expenditures in respect of scientific research, and for issuing an obligation whose proceeds are used for these purposes.

Subclause 8(5)

ITA 15.1(3)(c)

Paragraph 15.1(3)(c) of the Act defines "small business development bond". To qualify for treatment as a small business development bond, the issuer and the holder must file a timely joint election to treat the qualifying debt obligation as a small business development bond. The amendment to this paragraph extends the 90-day period for joint elections on bonds issued after 1981 and before the date on which this Bill receives Royal Assent.

Subclause 8(6)

ITA
15.1(9)

Under the existing law, only one small business development bond may be issued by a corporation or a related group of corporations. Subsection 15.1(9) is added to permit the issue after November 12, 1981 of more than one small business development bond by a corporation in financial difficulty. However, the total of all such bonds issued by the corporation and other related parties must not exceed $500,000.

ITA
15.1(10)

For a debt obligation to qualify as a small business development bond, a joint election must be made by the issuer and the holder of the obligation within 90 days of its issue. Subsection 15.1(10) is a new provision that sets out the circumstances in which an election may be filed after the 90-day period. This provision is retroactive to obligations issued after December 11, 1979—the date on which the provisions relating to small business development bonds were first made effective.

ITA
15.1(11)

A penalty is imposed under subsection 15.1(6) of the Act where a false declaration is made in a joint election in respect of a qualifying debt obligation. Subsection 15.1(11) is a new provision. By referring to section 163, the burden of establishing the facts justifying the penalty rests with the Minister of National Revenue. This applies to obligations issued after December 11, 1979.

ITA
15.1(12)

When property which has been financed by a small business development bond is disposed of, subsection 15.1(4) of the Act requires the net proceeds of disposition to be applied to reduce the amount of the bond. Subsection 15.1(12) is a new provision that allows the proceeds of disposition to be applied to acquire a replacement property rather than to pay off the debt. The replacement property must be acquired before the end of the taxation year following that in which the proceeds are received. The replacement property rule applies in the case of the theft, destruction or expropriation of property.

Subclauses 8(7) and (8)

These set out the effective dates for the amendments to section 15.1 of the Act.

Small Business Bonds

Clause 9

ITA 15.2

Section 15.2 is a new section which permits the issue of one or more small business bonds after November 12, 1981 and before 1984 in respect of an active business in Canada that is in financial difficulty and that is carried on by an individual resident in Canada or by a partnership of such individuals. The rules relating to small business bonds parallel the rules in section 15.1 of the Act relating to small business development bonds issued by corporations. The basic features of the small business bond are:

(a) the issuer cannot deduct the interest on the bond but the recipient of the interest is deemed to have received a taxable dividend from a taxable Canadian corporation;

(b) the bond must be issued after November 12, 1981 and before 1984;

(c) the principal amount must be at least $10,000 and not more than $500,000;

(d) the term must not exceed 5 years;

(e) the bond must be issued in circumstances of financial difficulty;

(f) all or substantially all of the bond proceeds must be used in Canada in a business carried on immediately before the time of issuance;

(g) a joint election must be made by the issuer and the holder in respect of the bond; a penalty is provided for making a false declaration in the election but the burden of establishing the facts justifying the penalty rests with the Minister of National Revenue;

(h) a mechanism is provided to permit more than one bond to be issued by an eligible issuer provided the aggregate original issue amount of such bonds does not exceed $500,000;

(i) some restrictions are placed on individuals or partnerships who are eligible to issue such bonds; the restrictions relate to small business bonds or small business development bonds previously issued by the individual, partnership or certain other parties who have a relationship with the issuer; and

(j) if during any period the issuer is not an eligible issuer or the proceeds from the issue are not used in the required manner, the issuer must pay additional tax equal to 34% of the interest payable on the bond for the period. Because the lender receives the interest payments as tax-free intercorporate dividends and is thereby in a position to accept a lower interest rate, the issuer has the responsibility of ensuring that he remains an eligible issuer and that the proceeds are used as required in his business.

Combined Income and Capital Receipts

Clause 10

Subclause 10(1)

ITA
16(1)

Subsection 16(1) of the Act deals with blended payments, such as mortgage payments, which consist of capital and income combined. This provision requires the income portion of a blended payment to be included in the recipient's income. Subsection 16(1) is amended to exclude from the ambit of the subsection the portion of any payment that is required by any other provision of the Act to be included in the recipient's income. For example, accrued interest income on a debt obligation that is included in income under subsection 12(3) or (4) of the Act will not also be required to be included in income under subsection 16(1) when the interest is actually paid. This amendment applies to the 1981 and subsequent taxation years.

Subclause 10(2)

ITA
16(4)(b)

Subsection 148(1) of the Act is amended to require the inclusion in income of amounts received by a taxpayer in satisfaction of rights under any annuity contract. Previously it applied only for life annuity contracts. The amendment to paragraph 16(4)(b) of the Act is consequential on the amendment to subsection 148(1). It excludes from the scope of subsection 16(1) any amounts received in satisfaction of rights under an annuity contract. This amendment applies to dispositions occurring after November 12, 1981.

Subclauses 10(3) and (4)

These set out the effective dates for the amendments to section 16 of the Act.

Deductions Prohibited —Business and Property Income

Clause 11

Subclause 11(1)

ITA 18(1)(m)

Paragraph 18(1)(m) of the Act prohibits a deduction for certain federal and provincial resource taxes or royalties. The amendment to the introductory wording of paragraph 18(1)(m) deletes the words "in the year" to ensure that resource royalties or taxes cannot be deducted in any year. In particular, the amendment will ensure that any resource royalty included in inventory as a cost will not result in a subsequent deduction of the royalty when the inventory is subsequently included in the cost of sales. The amendment applies to amounts paid or payable after May 6, 1974 in respect of the period after that date. Paragraph 18(1)(m) first became applicable after May 6, 1974.

Subclause 11(2)

ITA 18(1)(m)(v)

Subparagraph (v) of paragraph 18(1)(m) identifies the oil and gas and mineral interests which are subject to the rule prohibiting a deduction for Crown resource taxes and royalties. This subparagraph is amended to clarify that it applies with respect to all types of interests in Canadian mineral and oil and gas properties. It is also amended to allow for the deduction of Crown royalties in respect of the production of mineral by-products (for example, sulphur) from an oil or gas well. Income from such mineral production is treated for tax purposes as manufacturing and processing profits rather than resource profits. These amendments are applicable for taxation years commencing after 1982.

Subclause 11(3)

ITA 18(1)(p)

Section 18 of the Act prohibits certain decuctions in computing business or property income. A new paragraph (p) is added to subsection 18(1) relating to expenses incurred in a personal services business. Paragraph 18(1)(p) restricts the deduction of expenses of a personal services business of a corporation to the remuneration and cost of other benefits or allowances provided to an incorporated employee, certain expenses of the corporation associated with selling property or negotiating contracts that are ordinarily deductible from employment income, and amounts paid for legal expenses incurred by the corporation in collecting amounts owing for services rendered. This amendment applies to taxation years commencing after November 12, 1981.

ITA 18(1)(q)

Under the existing rules, a lease cancellation payment made by a lessor for the purpose of earning income from a business or property may be deductible under the ordinary rules relating to the computation of income. An example would be a payment by a landlord to obtain the cancellation of a lease held by a tenant in order to replace him with a new tenant who will pay a higher rent. An arm's length payment to cancel a lease which is not deductible under the ordinary rules—for example, because it was capital in nature—is deductible under paragraph 20(1)(z) of the Act. Under new paragraph 18(1)(q), no deduction is allowed for an amount paid or payable in respect of a lease cancellation payment except as provided by paragraph 20(1)(z) or (z.1) of the Act. The amendment to paragraph 20(1)(z) and the introduction of paragraph 20(1)(z.1) are discussed in the commentary on these provisions.

Paragraph 18(1)(q) applies to lease cancellations after December 1, 1982, other than a cancellation pursuant to an agreement in writing entered into on or before that date.

Subclause 11(4)

ITA
18(3.1) to (3.7)

Subsection 18(3.1) has been added to the Act to require expenses incurred in the construction, renovation or alteration of a building or in respect of the ownership of the related land to be capitalized rather than deducted on a current basis. These expenses are commonly referred to as "soft costs" and include, among other items, interest, legal and accounting fees and property taxes. The new rules relate only to those soft costs incurred during the period of construction, renovation or alteration. Subsection 18(3.3) provides for the determination of the date on which the construction, renovation or alteration is completed.

Subsection 18(3.2) corresponds to the existing rule in paragraph 18(3)(b) of the Act. It provides that certain interest payments, which otherwise might not be specifically identified with the construction, renovation or alteration of a particular building or the ownership of a particular parcel of land, are nonetheless subject to the rules relating to soft costs. Paragraph 18(3.2)(a) requires the capitalization of interest paid or payable by a taxpayer on borrowed money in circumstances where the borrowed money can reasonably be considered to have been used by the taxpayer in the construction, renovation or alteration. For example, where a corporation uses available cash to fund the construction of a building and borrows money to finance its trade receivables, a portion of the interest paid in respect of the money borrowed would fall within this paragraph.

Paragraph 18(3.2)(b) deals with indirect borrowings. If, for example, a taxpayer pays interest on borrowed money which he invests in a non-arm's length partnership that uses the funds to construct a building, the interest will not be deductible. The same rule would apply if the borrowed funds were invested in the shares of a corporation for the construction of a building, but in this case the rule would apply only if the investor were a specified shareholder of the corporation. A "specified shareholder" is defined in paragraph 125(9)(c) of the Act and generally means a person who has, or is related to a person who has, an interest of 10% or more in the corporation. The rules in subsection 18(3.2) do not apply to interest on money borrowed by a taxpayer where he reloans the money at a reasonable rate of interest.

Subsection 18(3.4) provides that the new rules relating to the capitalization of soft costs do not apply to a corporation whose principal business is the leasing, rental or sale, or development for lease, rental or sale, of real property owned by it, to or for persons with whom it deals at arm's length. For these corporations, which are generally referred to as principal-business corporations, or partnerships of such corporations, soft costs will continue to be deductible as incurred.

Subsections 18(3.5), (3.6) and (3.7) contain transitional provisions for the new rules relating to soft costs. Subsection 18(3.5) provides exemptions from the new rules in the following circumstances:

(a) where construction was in progress on November 12, 1981;

(b) where the installation of footings commenced after November 12, 1981 and before 1982;

(c) where arrangements for the construction were substantially advanced before November 13, 1981 and the installation of footings commenced before June 1, 1982; or

(d) where a written construction agreement was entered into before November 13, 1981, provided arrangements for the construction were substantially advanced before June 1, 1982 and the installation of footings commenced before 1983.

The transitional provisions require that the project proceed after 1982 without undue delay. Where a construction project is to consist of more than one building, the transitional provisions require that the construction of the first building proceed without undue delay after 1982, and the construction of all other buildings in the project proceed without undue delay before 1984.

Subsections 18(3.1) to (3.7) apply to outlays and expenses incurred after 1981.

Subclause 11(5)

ITA
18(4)(a)(ii)(B) and (C)

Subsections 18(4) to (8) of the Act establish thin capitalization rules for corporations limiting the deduction for interest on debts owing to certain non-residents. Under these rules, interest is disallowed where the corporation's debt-equity ratio in relation to the non-resident exceeds 3 to 1. The amendments to the thin capitalization rules are effective for taxation years commencing after November 12, 1981.

The amendments to clauses 18(4)(a)(ii)(B) and (C) of the Act relate to the calculation of the "equity" of the corporation for purposes of these rules. As amended, equity will include the retained earnings of the corporation, surplus contributed by specified non-resident shareholders of the corporation and the paid-up capital of shares owned by specified non-resident shareholders of the corporation. Previously, all contributed surplus and paid-up capital were taken into account.

Subclause 11(6)

ITA 18(5)

The amendment to subsection 18(4) of the Act necessitated definitions of "specified shareholder" and "specified non-resident shareholder" of a corporation. Subsection 18(5) of the Act is amended to provide these definitions and to make consequential changes to the definition "outstanding debts to specified non-residents".

Subclause 11(7)

ITA 18(11)

Paragraphs 20(1)(c), (d), (e) and (k) of the Act permit a deduction for interest and other expenses in respect of money borrowed for the purpose of gaining or producing income from a business or investment. Subsection 18(11) is a new provision which prohibits a deduction for interest or other expenses of borrowing money in respect of indebtedness incurred to:

(a) make a payment after November 12, 1981 for an income-averaging annuity contract, unless the contract was acquired pursuant to an agreement in writing entered into before November 13, 1981;

(b) pay a premium under a registered retirement savings plan after November 12, 1981;

(c) make an employee contribution to a registered pension fund or deferred profit sharing plan after November 12, 1981, other than a contribution to a registered pension plan required pursuant to an obligation entered into before November 13, 1981; or

(d) make a payment for an annuity whose cost is deductible under paragraph 60(l) of the Act.

Subclauses 11(8) to (13)

These set out the effective dates for the amendments to section 18 of the Act.

Deductions Permitted —Business and Property Income

Clause 12

Subclause 12(1)

ITA 20(1)(c)(iv)

Paragraph 20(1)(c) of the Act permits a deduction for interest paid in a year or payable in respect of a year in certain circumstances. Subparagraph 20(1)(c)(iv) is added to the Act to permit a deduction for interest paid or payable on money borrowed to acquire an annuity contract to which the accrual rules apply. Once the annuity payments have commenced, the amount of interest deductible with respect to the annuity is limited in any year to the amount of income on the annuity that is included in income by virtue of section 12.2 or paragraph 56(1)(d.1) of the Act. Where a taxpayer, who has a loan outstanding with respect to an annuity on which payments have commenced, elects to be taxed on the annual accrual basis, he will generally be in a position to take full advantage of the interest deduction. This amendment is effective for interest on money borrowed to acquire an annuity contract after June 28, 1982.

Subclause 12(2)

ITA 20(1)(j)

Paragraph 20(1)(j) of the Act permits a deduction on the repayment of loans to a shareholder which were previously included in income under section 15 of the Act. Paragraph 20(1)(j) is amended, effective for the 1982 and subsequent taxation years, to reflect the changes in the wording of subsection 15(2) of the Act.

Subclause 12(3)

ITA 20(1)(m.1)

Subsection 18(9) of the Act was introduced effective December 11, 1979 to deal with prepaid expenses. A prepaid insurance premium cannot be deducted in the year paid; rather, it can only be deducted in the year to which it reasonably relates. A new paragraph 20(1)(m.1) is added which effectively permits a manufacturer to deduct prepaid insurance premiums that he pays to insure against risks under extended warranties sold to his customers. This is accomplished by permitting the manufacturer, in computing income, to deduct a reasonable reserve for an obligation under an extended warranty arrangement where an amount has been included in his income under paragraph 12(1)(a) of the Act in respect of the services to be rendered or goods to be delivered under the warranty. The reserve must be in respect of goods and services that it is reasonably anticipated will have to be delivered or rendered after the end of the year and cannot exceed the prepaid portion of the premium that was payable to an insurer that carries on an insurance business in Canada. To qualify for the reserve, the warranty must be pursuant to a separate arm's length agreement and the only obligation under the warranty must be to provide goods or services with respect to property manufactured by the taxpayer or a related corporation. This amendment is effective for the 1979 taxation year, when the provisions of section 18 relating to prepaid expenses entered into force.

Subclause 12(4)

ITA
20(1)(z) and (z.1)

New paragraph 18(1)(q) of the Act provides that a lease cancellation payment made by the owner of property is not deductible except as permitted by paragraphs 20(1)(z) or (z.1) of the Act. Paragraph 20(1)(z) permits the deduction of a lease cancellation payment on an amortized basis, while paragraph 20(1)(z.1) provides for an immediate deduction of all or a part of a lease cancellation payment in certain circumstances where the property has been sold.

Where a lessor makes a lease cancellation payment, the amendment to paragraph 20(1)(z) requires that, as long as the property continues to be owned by the lessor or a person with whom he does not deal at arm's length, the payment be treated as a prepaid expense. As such, it may be deducted over the remaining term of the cancelled lease, including renewal periods, subject to a maximum limit of 40 years. Paragraph 20(1)(z.1) applies in the year in which the leased property is sold to an arm's length person. In such circumstances, the unamortized balance of the lease cancellation payment is immediately deductible in full except where the property to which the lease cancellation payment related is a capital property, in which case only one-half of the unamortized balance may be deducted.

This amendment applies to lease cancellations after November 12, 1981 subject to an exception for lease cancellations pursuant to agreements in writing entered into before November 13, 1981. As a result of the introduction of paragraph 18(1)(q) effective after December 1, 1982, the scope of paragraphs 20(1)(z) and (z.1) is expanded to cover all lease cancellation payments.

Subclause 12(5)

ITA
20(2.2)(a)

The amendment to paragraph 20(2.2)(a) is strictly consequential on the amendment to paragraph 148(1)(b) of the Act and now lists the various plans and contracts previously referred to in that paragraph.

This amendment is effective after November 12, 1981.

Subclause 12(6)

ITA
20(8)

Where property is sold in the course of a business, paragraph 20(1)(n) of the Act permits a deduction from income of a reasonable reserve for proceeds from the sale that are included in income from the business but are not due until a later year. The amendment to subsection 20(8) restricts the reserve to three years. It provides that a reserve is not deductible in calculating business income in any taxation year where the sale of property occurred more than 36 months before the end of that year.

This amendment applies with respect to property sold after November 12, 1981, except where the property is sold pursuant to the terms in existence on November 12, 1981 of an offer or agreement in writing made or entered into on or before that date.

Subclause 12(7)

ITA 20(12)

A foreign tax credit can be claimed by a taxpayer under section 126 of the Act in respect of "non-business-income tax" paid to a foreign government. The definition of this term in paragraph 126(7)(c) of the Act is amended to exclude any foreign tax repaid by the foreign government to any other person or partnership. Subsection 20(12) of the Act, which allows non-business-income tax to be deducted in computing income as an alternative to claiming a foreign tax credit, is amended as a consequence of this change. As amended, the subsection permits a deduction for any such repaid tax which is now to be excluded from the definition of non-business-income tax in paragraph 126(7)(c) of the Act. This amendment applies to taxation years commencing after November 12, 1981.

Subclause 12(8)

ITA 20(14)

Section 20(14) of the Act provides that accrued interest to the date of sale of a debt obligation is included in the income of the vendor and an offsetting deduction is permitted to the purchaser when he later receives the interest. The amendments to subsection 20(14) are consequential on the introduction of accrual rules for interest on debt obligations as provided in section 12 of the Act. The subsection is also amended so as not to apply to transfers of small business development bonds and small business bonds. These amendments are effective for transfers of debt obligations after November 12, 1981.

Subclause 12(9)

ITA 20(19)

Subsection 20(19) of the Act allows a special deduction to a corporation, partnership, unit trust or trust of which a corporation or a partnership is a beneficiary, to the extent that it has accrued an excess amount of income on a deferred annuity contract. This would occur where the amount of income accrued, determined under the existing rules by reference to the prescribed rate of interest, exceeds the income provided under the terms of the annuity contract. The over-accrual is deducted under the existing provision during the annuity payment period. This special deduction is discontinued for income earned on such annuities after 1982 as a consequence of the new accrual method which applies after 1982, but continues to permit a deduction during the annuity payment period for any over-accrual which has arisen before 1983.

ITA 20(20)

Subsection 20(20) of the Act is a new provision introduced to permit a deduction for any over-accrual to a taxpayer who owns a life insurance policy or an annuity contract. The deduction is allowed when the contract or policy is disposed of other than on a death. At the time the policy or contract is disposed of, the actual earnings under the policy or contract can be established and a deduction is permitted for any over-accrual. This new subsection is applicable to taxation years commencing after 1982.

ITA
20(21)

Subsection 20(21) of the Act is a new provision introduced to permit a deduction in respect of any over-accrual on a debt obligation in a taxation year in which it is disposed of at its fair market value. The deduction is limited to the amount by which the income previously included in the taxpayer's income on the obligation exceeds the total interest actually earned by him on the obligation. This new subsection is applicable to taxation years commencing after 1982.

ITA
20(22) and (23)

The deduction of employer contributions to a registered pension plan is provided for in paragraphs 20(1)(q) and (s) of the Act. Subsections 20(22) and (23) of the Act are new provisions which apply to taxation years commencing after November 12, 1981 and which have the effect of treating a related group of employers as a single employer for the purpose of determining the amount of the employer pension plan contribution that is deductible with respect to any particular employee. As a result, the maximum current service contribution that may be deducted by the group as a whole under paragraph 20(1)(q) in respect of a particular employee cannot exceed $3,500. Similarly, the maximum amount of a special employer contribution deductible under paragraph 20(1)(s) by each member in respect of a particular employee cannot exceed a proportionate share of the maximum amount that would be permitted as a deduction under that paragraph on the assumption there was only one plan, having regard to amounts deducted under paragraph 20(1)(q) by other members of the group.

Subclauses 12(10) to (18)

These set out the effective dates for the amendments to section 20 of the Act.

Capitalization of Interest Costs

Clause 13

ITA
21(1)(*a*) and (3)

Section 21 of the Act permits a taxpayer to elect to capitalize the cost of borrowed money used to acquire depreciable property. Subsection 18(3.1) has been added to the Act requiring real estate soft costs, including interest, incurred before the completion of construction of a building, to be capitalized. The amendments to paragraph 21(1)(*a*) and subsection 21(3) are consequential on the addition of subsection 18(3.1) and apply to outlays or expenses made or incurred after 1981. These amendments ensure that a section 21 election can be made during the construction period in respect of borrowing costs not otherwise deductible by virtue of subsection 18(3.1). These amendments are necessary to enable a taxpayer to make an election under subsection 21(3) in subsequent taxation years in respect of borrowing costs after the completion of the building which are not affected by subsection 18(3.1).

Fiscal Period of Proprietorship Ceasing Business

ITA
25(3)

Clause 14

When an individual disposes of a business carried on as a sole proprietorship, he may elect under subsection 25(1) of the Act to extend the fiscal year-end of the business to the date that otherwise would have applied if the business had been continued. Subsection 25(3) is added to the Act to provide that any recapture of capital cost allowance, or any terminal loss, and any income arising from the disposal of eligible capital property after the individual ceases to carry on the business, will be included as income of the business for that extended fiscal period. Under the existing law, such amount is required to be included in income in the calendar year in which the individual disposed of the property. This amendment applies to elections made after 1979.

Employer Contributions to Employee Benefit Plans

ITA
32.1(2)

Clause 15

Section 32.1 of the Act deals with the deduction of employer contributions to an employee benefit plan. The amount of the deduction allowed to an employer in any year depends on an annual allocation, by the plan's custodian, of payments made under the plan to employees or former employees. Subsection 32.1(2) is amended to extend the allocation to amounts paid out of such a plan to the heirs or legal representatives of employees or former employees. The effect of the amendment is to ensure that the employer deduction is not denied simply because the employee dies and the payment out of the plan is to an heir or to his legal representative. This amendment applies to the 1980 and subsequent taxation years.

Work in Progress of Certain Professions

ITA
34(1) and (2)

Clause 16

Section 34 of the Act provides an exception to full accrual accounting in calculating the income of a business that is a profession by allowing the income to be determined without taking into account any professional work in progress at the year end. The amendments to subsections 34(1) and (2) limit the application of this special rule to the professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor. Amendments to section 10 of the Act will require other persons to treat work in progress as inventory. This amendment applies to the 1983 and subsequent taxation years.

Clause 17

ITA
37(1)(f)

Subsection 37(1) of the Act permits a taxpayer to deduct scientific research expenditures of both a current and a capital nature. The maximum deduction available in any year is calculated on a cumulative basis by aggregating all expenditures made to the end of the year and deducting therefrom all amounts previously deducted in calculating the taxpayer's income. There is a technical deficiency in the existing provision that results in a double deduction in respect of capital expenditures claimed in previous years. This occurs because the deduction for capital expenditures in a year is reduced under both subparagraph 37(1)(b)(ii) and paragraph 37(1)(f) of the Act. The amendment to paragraph 37(1)(f) corrects this deficiency by excluding capital expenditures from the scope of this paragraph.

This technical deficiency arose as a result of changes made for taxation years ending after January 12, 1981 and the correcting amendment is therefore effective for those years.

Clause 18

Subclause 18(1)

ITA
39(1)(a)(iii)

Paragraph 39(1)(a) of the Act details the method by which a taxpayer's capital gain from the disposition of property is determined. Certain properties are excluded from these rules. Prior to its amendment, subparagraph 39(1)(a)(iii) excluded a life insurance policy other than one that was an interest in a segregated fund trust or a non-life annuity contract. The amendment to this subparagraph excludes other insurance policies and term-certain annuity contracts. The disposition of any annuity contract now gives rise to ordinary income under subsection 148(1) rather than a capital gain.

This amendment applies to dispositions occurring after November 12, 1981, except that with respect to the disposition of insurance policies other than life insurance policies, it applies to the 1980 and subsequent taxation years.

Subclause 18(2)

ITA
39(4)

Subsection 39(4) of the Act permits certain taxpayers to elect to treat all their Canadian securities as capital property, thereby ensuring that any gains or losses on their disposal will be capital in nature. This amendment to subsection 39(4) requires the election to be made in prescribed form. Before the amendment, the manner in which the election is to be made was not specified. This amendment applies to elections made for taxation years ending after the coming into force of the Bill.

Subclause 18(3)

ITA
39(5)(e) and (f)

Subsection 39(5) of the Act enumerates those taxpayers who may not make an election under subsection 39(4) to treat their Canadian securities as capital properties. The election is not available for traders or dealers in securities, life insurance corporations and other financial institutions. The amendment to paragraph 39(5)(e) of the Act adds general insurance corporations to this list. The amendment to paragraph 39(5)(f) of the Act ensures that any corporation whose principal business is the lending of money or the purchasing of debt obligations, or a combination of these activities, will also be denied the election. These amendments apply after November 12, 1981.

Subclauses 18(4) to (6)

These set out the effective dates for the amendments to section 39 of the Act.

Clause 19

Subclauses 19(1) and (2)

When in a taxation year a taxpayer disposes of capital property, the gain otherwise determined may be reduced under section 40 of the Act by a reasonable reserve in respect of proceeds of disposition that are not payable to the taxpayer until after the end of the year.

ITA 40(1)(a)

Subparagraph 40(1)(a)(iii) of the Act is amended to set a maximum of 5 years for reserves with respect to dispositions of capital properties. This amendment requires that at least one-fifth of the gain be recognized in the year of disposition of the property and in each of the four subsequent years. An exception to this general rule is provided in new subsection 40(1.1).

ITA 40(1.1)

Taxpayers may transfer certain farm property, shares of a family farm corporation, an interest in a family farm partnership and shares of a small business corporation to their children on a tax-deferred rollover basis or on a taxable basis, depending upon whether certain conditions are met. Those inter-generation transfers which are not made on a rollover basis and on which a gain arises will be subject to a restriction on the amount of any reserve which may be claimed. This is provided in subsection 40(1.1) of the Act which is added to allow a taxpayer in such circumstances to claim a reserve over a maximum ten-year period.

The amendment to subparagraph 40(1)(a)(iii) and the addition of subsection 40(1.1) to the Act apply to dispositions of property occurring after November 12, 1981 subject to certain transitional provisions.

Subclause 19(3)

ITA 40(6)

The rules relating to the capital gains exemption for a principal residence in section 54 of the Act are amended to provide that, with respect to capital gains which accrue after 1981, a family unit may treat only one residence as its principal residence for a taxation year. Subsection 40(6) of the Act is a new provision which provides transitional rules where more than one principal residence was owned by members of a family unit at the end of 1981. This subsection in effect provides that the capital gain realized after 1981 on the disposal of a principal residence cannot exceed the amount of the gain calculated as if it were determined in two parts—that part of the gain calculated to the end of 1981 on the basis of the old principal residence rules, plus the gain accruing after 1981 on the basis of the new rules. Thus, if the residence of a taxpayer qualified as a principal residence at the end of 1981 but did not so qualify after that date, only the portion of the gain that accrued before 1982 may qualify for the principal residence exemption. This situation may occur for example where, before 1982, the taxpayer and his or her spouse each owned a residence, both of which qualified as a principal residence in a taxation year. After 1981, only one such home may qualify as a principal residence in a taxation year. The entire gain on the home that is designated as a principal residence after 1981 will be exempt. This amendment applies to dispositions occurring after 1981.

Subclauses 19(4) and (5)

These set out the effective dates for the amendments to section 40 of the Act.

Capital Gains Reserves on Involuntary Dispositions

Clause 20

ITA 44(1)(e)(iii) and (1.1)

Section 44 of the Act allows a taxpayer to defer the recognition of a capital gain when an amount has become receivable as proceeds from an involuntary disposition of property (for example, theft, destruction or expropriation) or in respect of the disposition of a former business property of the taxpayer.

In calculating the gain for purposes of section 44, a reasonable reserve may be deducted for proceeds not payable until after the end of the year. Subparagraph 44(1)(e)(iii) is amended and subsection 44(1.1) is added to apply the same rules for determining the amount of this reserve as are to apply with respect to the reserve provisions of subparagraph 40(1)(a)(iii) of the Act. Thus, at least one-fifth of the gain must be recognized in the year of disposition and in each of the four subsequent years, except that in the case of certain farm property, shares of a family farm corporation, an interest in a family farm partnership or shares of a small business corporation transferred to a child, a minimum of one-tenth of the gain must be recognized each year.

The amendment to subparagraph 44(1)(e)(iii) and the introduction of subsection 44(1.1) to the Act apply to dispositions occurring after November 12, 1981 subject to certain transitional provisions.

Adoption of Canadian Residence by a Foreign Affiliate

ITA
48(5)

Clause 21

Subsection 48(5) is a new provision. It sets out the tax consequences when a foreign affiliate of a taxpayer becomes resident in Canada. The new provision deems the taxation year of a foreign affiliate to have ended immediately before becoming resident in Canada and deems the affiliate to have been a controlled foreign affiliate at the end of such year. Regulations will be prescribed adding to the foreign accrual property income of the affiliate the taxable surplus of the affiliate (subject to certain adjustments) and the amount that would have been added to its taxable surplus or foreign accrual property income if it had disposed of its capital property at fair market value immediately before such year end. This amendment must be considered in conjunction with subsection 91(1) of the Act. That subsection requires that the foreign accrual property income of a controlled foreign affiliate of shareholders resident in Canada be included in the income of such shareholders, whether or not such income has been distributed. The effect of the amendment will thus be to require the inclusion in income of amounts that are not now subject to tax. Subsection 48(5) of the Act is applicable to foreign affiliates that become resident in Canada after November 12, 1981.

Clause 22

Section 53 of the Act provides that in computing the adjusted cost base of property for the purpose of determining a capital gain or loss, certain adjustments be made to the cost of such property. Subsection 53(1) provides for additions to the cost and subsection 53(2) for deductions from the cost. There are a number of amendments to section 53 of the Act, most of which are consequential on other amendments.

Subclause 22(1)

ITA
53(1)(e)(i)(B)

Paragraph 53(1)(e) of the Act sets out the rules for determining the adjusted cost base of a partnership interest. Subparagraph (i) thereof provides for the addition of a partner's share of the partnership income to the cost of a partnership interest. The amendment made to clause 53(1)(e)(i)(B) is consequential on the addition of subsection 69(7.1) to the Act and provides that there will be no addition in calculating the adjusted cost base of a partnership interest for the special addition to income under paragraph 69(7.1)(b) of the Act upon the sale by the partnership of aviation turbine fuel for use on an international flight. This amendment applies to taxation years ending after January 31, 1982.

Subclause 22(2)

ITA
53(1)(e)(ii)

Subparagraph 53(1)(e)(ii) of the Act provides for the addition, in calculating the adjusted cost base of a partnership interest, of capital dividends received by the partnership. This is offset by a reduction when capital dividends are withdrawn from the partnership. The amendment to this subparagraph is consequential on the introduction of life insurance capital dividends. This amendment applies after June 28, 1982.

Subclause 22(3)

ITA
53(1)(e)(x)

Section 97 of the Act is applicable where property of a partner is transferred to a partnership. Subparagraph 53(1)(e)(x) is added to the Act to clarify that the adjusted cost base of a partnership interest is to be increased by any amount required to be included in the adjusted cost base of the interest by virtue of section 97. This amendment complements an amendment to paragraph 53(2)(c) of the Act and applies to dispositions occurring after November 12, 1981.

Subclause 22(4)

ITA
53(1)(m)

Paragraph 53(1)(m) of the Act is repealed. As a result of the amendment to subparagraph 39(1)(a)(iii) of the Act which excluded non-life annuity contracts from capital gains treatment, it is no longer necessary to determine the adjusted cost base of an annuity contract. This amendment applies to dispositions occurring after November 12, 1981.

Subclause 22(5)

ITA
53(2)(a)(iv)

Paragraph 53(2)(a) of the Act requires certain amounts to be deducted in computing the adjusted cost base of a share of the capital stock of a resident corporation. Subsections 84(1) to (4) of the Act treat certain corporate transactions as giving rise to a dividend except for certain circumstances described in the new subsection 84(8) of the Act relating to public corporations. In those circumstances, the shareholder is now treated as receiving either a return of capital or proceeds of disposition of his share. Subparagraph 53(2)(a)(iv) is added to the Act so that, when subsection 84(8) treats the shareholder in effect as receiving a return of capital, the adjusted cost base of his share will be reduced by the amount of the distribution. Subparagraph 53(2)(a)(iv) of the Act applies with respect to amounts received after November 12, 1981.

Subclause 22(6)

ITA
53(2)(c)(i)(B)

Subparagraph 53(2)(c)(i) of the Act requires a deduction, in computing the adjusted cost base of property that is a partnership interest, for a partner's share of partnership losses. The amendment to clause 53(2)(c)(i)(B) of the Act is consequential on the addition of subsection 69(7.1) of the Act which provides for a special addition to income on the sale of aviation turbine fuel for use on an international flight. The effect of the amendment is that, for purposes of the reduction in the adjusted cost base, a loss of the partnership is to be determined without reference to this special addition to income. This adjustment is necessary because the special addition deemed to be received by a partnership by virtue of paragraph 69(7.1)(b) of the Act is included in income for tax purposes only and does not reflect any additional asset or cash flow. This amendment applies to taxation years ending after January 31, 1982.

ITA
53(2)(c)(i)(C)

The addition of clause 53(2)(c)(i)(C) to the Act is consequential upon the addition of subsections 112(3.1) and 112(4.2) of the Act. These subsections modify the stop-loss rules relating to shares. Subsection 112(3.1) provides that a corporate partner's share of a partnership loss on a share that is capital property will be reduced in certain circumstances by dividends received by the partner with respect to shares owned by the partnership. Similarly, subsection 112(4.2) limits losses attributed to a partner from shares owned by the partnership that are not capital property. Clause 53(2)(c)(i)(C) provides that in such circumstances, the adjusted cost base of the partnership interest of that partner will not be reduced to the extent that the loss attributed to the partner is limited by subsection 112(3.1) or (4.2). Clause 53(2)(c)(i)(C) applies in determining the adjusted cost base of partnership interests after November 12, 1981.

Subclause 22(7)

ITA
53(2)(c)(iv)

Section 97 of the Act applies where property is transferred by a partner to a partnership. Subparagraph 53(2)(c)(iv) is added to the Act to reflect in the adjusted cost base of a partnership interest any amount required to be deducted from the adjusted cost base of a partner's interest in a partnership by virtue of section 97. This amendment complements an amendment adding subparagraph 53(1)(e)(x) to the Act and is consequential on the revision to subparagraph 97(2)(b)(ii) made by the Bill. Subparagraph 53(2)(c)(iv) of the Act applies to dispositions occurring after November 12, 1981.

Subclause 22(8)

ITA
53(2)(c)(vi)

Paragraph 53(2)(c) of the Act provides for certain deductions in computing the adjusted cost base of a partnership interest. Subparagraph 53(2)(c)(vi) is added to the Act to require that a deduction be made for that part of the investment tax credit claimed by the taxpayer pursuant to subsection 127(5) of the Act which can be reasonably attributed to the taxpayer's share of the partnership's investment tax credit. Subparagraph 53(2)(c)(vi) of the Act applies with respect to investment tax credits deducted for the 1982 and subsequent taxation years.

Subclause 22(9)

ITA
53(2)(h)

Paragraph 53(2)(h) of the Act requires that a deduction be made in computing the adjusted cost base of a taxpayer's capital interest in a trust or unit of a unit trust for any amount paid by the trust as a distribution of capital. Subparagraph 53(2)(h)(ii) is added to require a deduction relating to that part of the investment tax credit claimed by the taxpayer pursuant to subsection 127(5) of the Act that can reasonably be attributed to his designated portion of the trust's investment tax credit. This amendment applies with respect to investment tax credits deducted for the 1982 and subsequent taxation years.

Subclause 22(10)

ITA
53(2)(l)

When a debt obligation is purchased and an amount is paid by the purchaser to the vendor in respect of accrued interest, subsection 20(14) of the Act permits the purchaser to deduct the amount of the accrued interest paid to the vendor. In these circumstances, paragraph 53(2)(l) requires the adjusted cost base of the debt obligation to be reduced by the amount of the deduction claimed by the purchaser for accrued interest. The amendment to paragraph 53(2)(l) substitutes the term "debt obligation" for the expression "bond, debenture or similar security". This conforms to a similar amendment made to subsection 20(14) of the Act. This amendment applies to dispositions occurring after November 12, 1981.

Subclause 22(11)

ITA
53(2)(r)

Paragraph 53(2)(r) of the Act previously required a deduction in determining the adjusted cost base of a non-life annuity contract. The repeal of this provision is consequential on the amendment to subparagraph 39(1)(a)(iii) of the Act. The former paragraph 53(2)(r) is replaced by an entirely new provision relating to the adjusted cost base of a share of the capital stock of a corporation held by a taxpayer. New paragraph 53(2)(r) requires the amount of a life insurance capital dividend to be deducted in computing the adjusted cost base of a share of a corporation, or of a share substituted for such a share, that is transferred to the taxpayer or to a person related to the taxpayer as a consequence of the death of a person. The deduction only applies where the corporation made the appropriate election under new subsection 83(2.1) to treat the dividend as a life insurance capital dividend. The amendment ensures that the deceased taxpayer's estate, heirs or beneficiaires cannot use a tax-free life insurance capital dividend to generate a capital loss or reduce a capital gain on the disposition of the shares. The details of the new life insurance capital dividend account are explained in the commentary for new paragraph 89(1)(b.2) of the Act. This amendment applies after June 28, 1982.

Subclauses 22(12) to (18)

These set out the effective dates for the amendments to section 53 of the Act.

Capital Gains and Losses—Definitions

Clause 23

Subclause 23(1)

ITA
54(c)(ii)(C)

Paragraph 54(c) of the Act defines those transactions or events which give rise to a "disposition" of property. There is some uncertainty concerning the meaning of the term "amalgamation" in this paragraph. Clause 54(c)(ii)(C) is amended to clarify that a share conversion effected by means of a merger or an amalgamation is considered to be a disposition of the share. This amendment applies to share conversions occurring after November 12, 1981.

Subclause 23(2)

ITA
54(c)(v)

Paragraph 54(c)(v) of the Act specifically provides that a change in legal ownership is not a disposition of property if there is no change in beneficial ownership. There is an exception where the property is transferred to a trust governed by certain profit sharing or registered plans or funds. In these circumstances, the property will be deemed to have been disposed of at fair market value. The amendment to paragraph 54(c) adds a further exception for a transfer of property by a trust resident in Canada to a trust not resident in Canada. Consequently, transfers of property between such trusts will be recognized as dispositions for income tax purposes. This amendment prevents an opportunity for trustees resident in Canada to arrange for a transfer of trust property free of tax to non-resident trustees who could subsequently dispose of the property and thereby avoid Canadian tax liability. The amendment applies with respect to transfers occurring after November 12, 1981.

Subclause 23(3)

ITA
54(g)(iii)

Under the existing rules, a married couple may claim the benefit of the capital gains exemption for a principal residence in respect of two residences where, for example, one spouse owned a city house and the other owned a country house. The amendment to the definition of "principal residence" in paragraph 54(g), taken together with the addition of subsection 40(6) of the Act, provides that, for capital gains accruing after the end of 1981, a family unit may treat only one housing unit as its principal residence for a taxation year.

Subparagraph 54(g)(iii) is amended so that only one housing unit per family unit may be designated as a principal residence for any year after 1981. A family unit for these purposes consists of a taxpayer, his spouse (other than a spouse who was throughout the year living apart from the taxpayer and was separated pursuant to a judicial separation or written separation agreement) and his unmarried children under age 18. Where two or more members of a family unit have an interest in the same housing unit, the new rule will not prevent each such member from claiming the principal residence exemption in respect of any gain realized by him on the sale of his interest. Thus, for example, where husband and wife own their house jointly, each may designate it as his or her principal residence. This amendment applies to designations made in respect of the 1982 and subsequent taxation years.

Subclause 23(4)

ITA
54(g)

The amendment to the closing words of the definition of principal residence in paragraph 54(g) of the Act converts the measurement unit referred to in the provision to its metric equivalent. The term "½ hectare" replaces "one acre". This amendment applies to dispositions occurring after 1981.

Subclause 23(5)

ITA
54(h)(x)

Paragraph 54(h) of the Act defines the term "proceeds of disposition" of property. Subparagraph 54(h)(x) provides that the proceeds of disposition of a share does not include any amount that is deemed by subsection 84(2) or (3) of the Act to be a dividend in respect of the share. These provisions deal with distributions on the winding-up or reorganization of a business and on the redemption of shares. The amendment to subparagraph 54(h)(x) is consequential upon the addition of subsection 84(8) to the Act which deems a dividend not to have been received in certain circumstances described in subsections 84(2) or (3). Subparagraph 54(h)(x) is amended to exclude from proceeds of disposition only those dividends that are deemed to be dividends received. This amendment applies to dividends paid after November 12, 1981.

Subclause 23(6)

ITA
54(i)(iii)

A loss which is categorized as a "superficial loss" is deemed to be nil for tax purposes and, therefore, is not allowed as a capital loss. The concept of a superficial loss is defined in paragraph 54(i) of the Act. A loss which would otherwise be a superficial loss is allowable as a capital loss if it arose by virtue of a disposition enumerated in subparagraph 54(i)(iii).

The amendment to subparagraph 54(i)(iii) of the Act, which applies after November 12, 1981, adds to the list of enumerated dispositions those referred to in subsections 138(11.3) and 149(10) of the Act. These subsections deem dispositions to have occurred when there is a change of use of property by an insurer in certain defined instances and when a corporation ceases to be tax-exempt. In these instances, any loss arising as a result of a deemed disposition of property will not be treated as a superficial loss.

Subclauses 23(7) to (12)

These set out the effective dates for the amendments to section 54 of the Act.

Principal Residence—Special Relocation Rule

ITA
54.1(2)

Clause 24

Section 54.1 of the Act sets out a special exception to the principal residence rules. Under the ordinary rules, if a housing unit is not ordinarily inhabited in a year and is rented out, it can continue to qualify as a principal residence for a maximum of 4 years when the taxpayer so elects under subsection 45(2) of the Act. However, under section 54.1 of the Act, it can continue to qualify indefinitely provided the property is not ordinarily inhabited by the taxpayer as a consequence of a relocation of his place of employment or that of his spouse. To qualify under this provision, the work relocation move must be to a place that is at least 25 miles closer to the new place of employment. The amendment to subsection 54.1(2) converts this distance test to its metric equivalent—"40 kilometres" rather than "25 miles". This amendment applies to relocations occurring after 1981.

Capital Gain Strips

Clause 25

Section 55 of the Act sets out the rules designed to counter the avoidance of tax on certain transactions that would otherwise allow what is generally referred to as "capital gain strips".

Subclause 25(1)

ITA 55(2)

Subsection 55(2) deals with certain inter-corporate dividends that are ordinarily tax-free. To prevent the avoidance of tax, such dividends are treated as proceeds of disposition of a share or a gain from the disposition of capital property. There are certain exceptions to this treatment and amendments to subsection 55(2) of the Act affect two of these exceptions.

Subsection 55(2) does not deny dividend treatment when the gain is attributable to income earned or realized by a corporation after 1971. The first change clarifies that, for this purpose, post-1971 income is to be calculated up to the date of the relevant transaction or event or the commencement of the relevant series of transactions or events that bring subsection 55(2) into play. Thus, the income of a corporation earned or realized subsequent to that date cannot be used to reduce the tax liability resulting from the application of subsection 55(2).

Subsection 55(2) does not apply to dividends subject to the refundable tax under Part IV of the Act. The second change provides that the exception for dividends subject to Part IV tax will only apply if the tax is not refunded as a consequence of the payment of an inter-corporate dividend that is part of the series of transactions or events. These changes apply to dividends received after November 12, 1981.

Subclause 25(2)

ITA 55(3)(b)

Subsection 55(2) of the Act does not apply to a dividend received by a corporation in the course of a corporate reorganization described in paragraph 55(3)(b) of the Act and frequently referred to as a "butterfly" transaction. This is a transaction in which property of a corporation is transferred to its corporate shareholders on a tax-deferred basis as part of a reorganization, provided each shareholder receives its pro-rata share of each type of property of the corporation.

The amendments to paragraph 55(3)(b) of the Act, taken together with the amendments to paragraph 88(1)(d), seek to prevent an inappropriate increase in the adjusted cost base of assets as a result of carrying out the various steps in a butterfly reorganization. Paragraph 55(3)(b), as amended, requires that, at the completion of the reorganization, the transferee of the property must be the person who was the corporate shareholder at the commencement of the reorganization. If, as an intermediate step, the property is transferred to another corporation owned by the corporate shareholder, that other corporation must be wound up or amalgamated so that the corporate shareholder or its successor is the ultimate transferee of the property. In addition, there is a requirement that the corporate shareholder retain its shares in the transferor corporation throughout the reorganization. These amendments apply to transfers of property occurring after June 28, 1982.

Subclauses 25(3) and (4)

These set out the effective dates for the amendments to section 55 of the Act.

Inclusions in Income from Other Sources

Clause 26

Subclause 26(1)

ITA
56(1)(a)

Paragraph 56(1)(a) of the Act includes in the income of a taxpayer certain amounts received in a taxation year. The amendment adds the words "by the taxpayer" after the word "received" for clarification. This amendment applies to the 1982 and subsequent taxation years.

Subclause 26(2)

ITA
56(1)(a)(i)

Subparagraph 56(1)(a)(i), which includes pension benefits in income, previously expressly excluded certain social assistance payments from income. The amendment removes the exclusion for social assistance payments. These assistance payments are now included in income under paragraph 56(1)(u) of the Act but may be deducted in computing taxable income under paragraph 110(1)(f) of the Act. The amendment to subparagraph 56(1)(a)(i) applies to the 1982 and subsequent taxation years.

Subclause 26(3)

ITA
56(1)(a)(vi) to (viii)

Subparagraphs 56(1)(a)(vi) to (viii) of the Act are being repealed and a new subparagraph 56(1)(a)(vi) is substituted.

As they formerly read, subparagraphs 56(1)(a)(vi) and (vii) included in income adjustment assistance benefits payable under various regulations to persons employed in four specific industries. The *Labour Adjustment Benefits Act*, which was proclaimed in 1982, brings all these regulations together under one piece of legislation and extends the payment of these benefits to employees in additional industries. Since all adjustment assistance benefits will now be payable under this new Act, subparagraphs 56(1)(a)(vi) and (vii) are no longer necessary and all adjustment assistance benefits will now be brought into income under new subparagraph 56(1)(a)(vi) which makes specific reference to that Act. These amendments apply to amounts received after 1981 under the *Labour Adjustment Benefits Act*.

The repeal of subparagraph 56(1)(a)(viii) of the Act, which included a termination payment in income, is consequential on the repeal of the definition "termination payment" in subsection 248(1) of the Act and a change to the definition of "retiring allowance" in that same subsection. Since a termination payment is now treated as a retiring allowance, it will be included in income under subparagraph 56(1)(a)(ii) of the Act. This amendment applies to amounts received in respect of any termination of an office or employment after November 12, 1981, other than retirements occurring before 1982 pursuant to an arrangement made before November 13, 1981.

Subclause 26(4)

ITA
56(1)(c) and (c.1)

Paragraph 56(1)(c) of the Act requires the inclusion in income of periodic maintenance allowances received by a separated spouse or common-law spouse. Paragraph 56(1)(c) is amended to restrict its application to separated persons who were legally married and a new paragraph 56(1)(c.1) is added with respect to payments under provincial laws which recognize a support obligation with respect to common-law spouses on a breakdown of their relationship. Complementing amendments are made to section 60 relating to the tax treatment of maintenance payments from the point of view of the recipient.

ITA
56(1)(d)

Paragraph 56(1)(d) of the existing Act requires all annuity payments to be brought into income other than payments otherwise required to be included in income. Where an annuity payment is included in income by this paragraph, a deduction may be claimed under paragraph 60(a) for the capital portion of that payment as determined under Part III of the Income Tax Regulations. The amendment to paragraph 56(1)(d) excludes payments received under annuity contracts subject to the accrual rules under subsection 12.2(1), (3) or (4) of the Act. As amended, paragraph 56(1)(d) will apply after December 1, 1982 only to prescribed annuity contracts (see explanation under subsections 12.2(6) and (7)), annuities arising under the settlement option of a life insurance policy acquired before December 2, 1982 and annuities where payments have commenced before December 2, 1982.

ITA
56(1)(d.1)

New paragraph 56(1)(d.1) of the Act, applicable after December 31, 1982, requires the holder of an annuity contract to include in his income the amount received in a year on an annuity contract subject to the accrual rules. This inclusion is limited to the amount of the accrued income on the contract at the end of the year. Paragraph 56(1)(d.1) does not apply to payments under an annuity contract in any year in which new section 12.2 of the Act requires an amount accrued on the contract to be included in the taxpayer's income. The accrued income computed at the end of each year for the purpose of this paragraph is the amount by which the accumulating fund at the end of the calendar year exceeds the total of the adjusted cost basis of the contract and its unallocated pre-1982 income. This computation is analogous to the computation done for purposes of subsections 12.2(1) and (3) and explained in the commentary on those subsections. Paragraph 56(1)(d.1) is applicable after December 1, 1982.

ITA
56(1)(d.2)

Paragraph 60(l) of the Act has been amended to allow certain recipients of a refund of premiums under a registered retirement savings plan to transfer the refund on a tax-free basis into a particular form of annuity contract. The refund of premiums is deductible to the extent of the cost of the annuity and paragraph 56(1)(d.2) requires the full amount of each annuity payment to be brought into the recipient's income when received. New paragraph 56(1)(d.2), applicable to the 1982 and subsequent taxation years, accomplishes this by including in income both the full amount of each annuity payment and any proceeds of disposition of this type of annuity.

Subclause 26(5)

ITA
56(1)(u) and (v)

Certain types of social assistance were previously excluded from income under subparagraph 56(1)(a)(i) of the Act. Paragraph 56(1)(u) is added to the Act to require that social assistance payments received by a person or his spouse be included in the income of the spouse with the higher income for the year. Thus, the spouse with the higher income will maintain his or her entitlement to the married exemption under paragraph 109(1)(a) of the Act in respect of the other spouse. The amount included in income under paragraph 56(1)(u) is deductible in computing taxable income under paragraph 110(1)(f) of the Act. This change places social assistance payments on the same basis as the guaranteed income supplement and the spouses' allowance under the *Old Age Security Act*.

Paragraph 56(1)(v) is added to the Act to require workmen's compensation benefits to be included in the recipient's income. These benefits, while included in income, are also deductible in determining the recipient's taxable income under paragraph 110(1)(f) of the Act as amended.

These amendments relating to social assistance payments and workmen's compensation apply to the 1982 and subsequent taxation years.

Subclause 26(6)

ITA
56(9)

The amendment to subsection 56(9) of the Act is consequential on the changes relating to social assistance payments so that, in determining which spouse has the higher income for the purposes of paragraph 56(1)(u). the social assistance payments are themselves not included. This amendment applies to the 1982 and subsequent taxation years.

Subclauses 26(7), (8) and (9)

These set out the effective dates for the amendments to section 56 of the Act.

Third-Party Maintenance Payments Included in Income

ITA
56.1

Clause 27

Section 56.1 of the Act treats certain alimony and maintenance payments made to third parties for the benefit of a taxpayer (or children in the custody of the taxpayer) as having been received by the taxpayer so that such payments will be included in the income of the taxpayer. Section 56.1 is amended to add a cross-reference to the new paragraph 56(1)(c.1). It also provides independent authority with respect to payments pursuant to provincial laws that recognize a support obligation in the case of common-law spouses on a breakdown of their relationship. Complementary amendments are made to section 60.1 of the Act relating to the tax treatment of payments from the point of view of the payor.

This amendment applies to payments made after December 11, 1979, in the case of an order made after that date, and, in any other case where the taxpayer and the payor agree in writing at any time in a taxation year, to payments made in the year and subsequent years.

Clause 28

Subclause 28(1)

ITA
60(a)

Paragraph 60(a) of the Act permits a deduction for the capital element of an annuity payment other than certain annuity payments received under those registered plans the entire amount of which is required to be included in income. The amendment limits the deduction to the capital element of these annuities on which an amount is required by paragraph 56(1)(d) to be included in income. This amendment is consequential on the introduction of accrual rules for annuities.

Subclause 28(2)

ITA
60(c) and (c.1)

Paragraph 60(c) of the Act permits a deduction for a periodic maintenance allowance paid by a separated spouse or by a separated common-law spouse where provincial law recognizes a support obligation. Paragraph 60(c) is amended so that it applies only to separated legally married persons, and a new paragraph 60(c.1) is added with respect to payments under provincial laws which recognize a support obligation with respect to common-law spouses on a breakdown of their relationship. Complementary amendments are made to section 56 relating to the tax treatment of maintenance payments from the point of view of the recipient.

These amendments apply to payments made after December 11, 1979, in the case of an order made after that date, and, in any other case where the taxpayer and the recipient agree in writing at any time in a taxation year, to payments made in the year and subsequent years.

Subclause 28(3)

ITA
60(e)

Paragraph 60(e) of the Act permits a student to deduct tuition fees where the student was in full-time attendance at a university outside Canada in a course leading to a degree. The deduction is not available where the fees are paid by the student's employer and the amount of such payment is excluded from the student's income. Paragraph 60(e) is amended to extend this limitation to fees paid by the employer of the student's parent and not included in the parent's income by virtue of subparagraph 6(1)(b)(ix) of the Act. This amendment applies to the 1982 and subsequent taxation years.

Subclause 28(4)

ITA
60(f)

Paragraph 60(f) of the Act permits a student to deduct tuition fees paid to certain Canadian educational institutions. Paragraph 60(f) is amended in several respects. First, the threshold for deductible tuition fees is increased from $25 to $100. Second, the fees will not be deductible if the fees are part of an allowance received by the student's parent that is excluded from income under subparagraph 6(1)(b)(ix) of the Act. Third, the courses, offered by an educational institution certified by the Minister of Employment and Immigration, must furnish a person with skills for, or improve a person's skills in, an occupation. These amendments are applicable to the 1982 and subsequent taxation years.

Subclause 28(5)

ITA 60(g)

Paragraph 60(g) of the Act permits a student residing in Canada near the Canada-United States border to deduct tuition fees paid to a United States university or college where the student commutes to that institution. Paragraph 60(g) is amended to increase the threshold for deductible tuition fees from $25 to $100 and to disallow the deduction where the fees are part of an allowance received by the student's parent that is excluded from income under subparagraph 6(1)(b)(ix) of the Act. This amendment applies to the 1982 and subsequent taxation years.

Subclauses 28(6), (7) and (8)

ITA 60(j)

The rules for the tax-free transfer of a retiring allowance to a registered pension plan or a registered retirement savings plan are now dealt with in paragraph 60(j.1) of the Act. Thus, the reference to a retiring allowance has been removed from paragraph 60(j).

ITA 60(j.1)

Paragraph 60(j.1) of the Act is a new provision which limits the amount of a retiring allowance that can be transferred on a tax-free basis to a registered pension plan or a registered retirement savings plan. This amount cannot exceed $2,000 for each year the retiree was employed by his employer or a person related to his employer plus $1,500 for each year for which employer contributions to a registered pension plan or deferred profit sharing plan have not vested in the retiree. For this purpose, the number of years of vesting is determined by reference to the terms of the particular plan and can be a fractional number of years. For example, if an employee has worked for 7 years for his employer, his employer has made contributions in each of those years and at the time of his retirement 60% of employer contributions have vested, the number of years which may be counted for the additional $1,500 retiring allowance will be 2.8 (7 minus 60% of 7). For the purpose of this provision, the meaning of a "person related to an employer" is expanded beyond the standard meaning assigned by section 251 of the Act to include any person whose business was acquired or continued by the employer and to include also a previous employer of the retiree whose service therewith is recognized in determining the retiree's pension benefits.

ITA 60(k)(iii)(A)

The rules relating to the tax-free transfer of a retiring allowance are now reflected in paragraph 60(j.1) of the Act. Therefore, the reference to subparagraph 56(1)(a)(ii) has been removed from clause 60(k)(iii)(A) of the Act.

These amendments apply to retirements occurring after November 12, 1981, other than retirements occurring before 1982 pursuant to an arrangement made before November 13, 1981.

Subclause 28(9)

ITA
60(l)

Paragraph 60(l) of the Act deals with the tax-free transfer of a refund of premiums under a registered retirement savings plan ("RRSP"). By definition, a refund of premiums may be received by the surviving spouse of the annuitant or, if the annuitant had no spouse, by a dependent child under age 26 or a dependent child 26 or over who is dependent by reason of physical or mental infirmity. Paragraph 60(l) permitted a surviving spouse under 72 years of age to transfer the refund of premiums on a deferred-tax "rollover" basis into a RRSP. This paragraph has been amended to permit a surviving spouse aged 71 or over or a child who is dependent by reason of physical or mental infirmity to transfer a refund of premiums tax-free to an annuity. The annuity must be for life or to age 90 and it must provide for annual or more frequent periodic payments which the annuitant must begin to receive within one year of purchasing the annuity.

The full amount of each periodic payment under this form of annuity is brought into the recipient's income by virtue of new paragraph 56(1)(d.2). An amendment has also been made to the definition of pension income in subsection 110.2(3) of the Act to refer to this type of annuity payment so that it will qualify for the pension income deduction.

This form of annuity represents an alternative to the income averaging annuity contract ("IAAC") into which a surviving spouse over age 71 or certain dependants could formerly make a tax-free transfer of refunds of premiums under RRSPs.

This amendment will apply to the 1982 and subsequent taxation years.

Subclause 28(10)

ITA
60(n)(ii.1)

Subparagraph 60(n)(ii.1), which permits the deduction of repayments of benefits received under the *Labour Adjustment Benefits Act,* is added to the Act. The receipt of these benefits will now be taxed under new subparagraph 56(1)(a)(vi) and their repayment is also deductible under the Act. This amendment applies with respect to amounts repaid after 1981.

Subclause 28(11)

ITA
60(q)(i)

Paragraph 60(q) of the Act permits an individual to deduct repayments he is required to make in respect of certain bursaries and other amounts paid to him for furthering his education. To obtain the deduction, subparagraph 60(q)(i) previously required the amount paid to the individual to be included in his income as salary or wages, a scholarship or bursary described in subparagraph 56(1)(n)(i), or a research grant described in paragraph 56(1)(o). This amendment removes the reference to salary or wages so that the deduction under paragraph 60(q) will only be available if the amount paid was included in income as a scholarship, bursary or research grant. New paragraph 8(1)(n) of the Act allows a deduction where an employee reimburses an amount previously included in his employment income. This amendment applies to the 1981 and subsequent taxation years.

Subclauses 28(12) to (17)

These set out the effective dates for the amendments to section 60 of the Act.

Deductible Third-Party Maintenance Payments

Clause 29

ITA
60.1

Section 60.1 of the Act treats certain alimony and maintenance payments paid by a taxpayer to a third party for the benefit of the taxpayer's spouse, former spouse, or common-law spouse where provincial law recognizes a support obligation, as having been paid to and received by such spouse so that the payments are deductible by the taxpayer. Section 60.1 is amended to add a cross-reference to the new paragraph 60(c.1) of the Act. It also provides independent authority with respect to payments pursuant to provincial laws that recognize a support obligation in the case of common-law spouses on a breakdown of their relationship. The amendments to this section complement those made to section 56.1 of the Act relating to the tax treatment of payments from the point of view of the recipient.

This amendment applies to payments made after December 11, 1979, in the case of an order made after that date, and, in any other case where the taxpayer and the recipient agree in writing at any time in a taxation year, to payments made in the year or subsequent years.

Income-Averaging Annuity Contracts

Clause 30

ITA
61(4)(b) and (c)

Section 61 of the Act provided a system of forward averaging for individuals through the purchase of an income-averaging annuity contract. This system is being replaced by a new method of forward averaging. In order to phase out the old system, paragraph 61(4)(b) of the Act, which contains the definition of income-averaging annuity contract, is amended so that, subject to a transitional rule, the only contract made by an individual after November 12, 1981 which will come within the definition is one under which all payments are made under the contract to the individual before 1983. Thus, it was possible to purchase an income-averaging annuity contract after November 12, 1981 and before March 2, 1982 and thereby transfer qualifying income from 1981 to 1982.

The transitional rule permits the old rules to apply to an income-averaging annuity contract where the payment for the contract was made on or after November 13, 1981 and either of two conditions were met: first, if the payment was made pursuant to an agreement in writing entered into before that date to make such a payment in respect of the 1981 taxation year, and second, if the payment was made pursuant to an arrangement in writing made before that date to have funds withheld before 1982 from the individual's remuneration which is qualifying income earned or received before November 13, 1981 and paid by or on behalf of the individual.

Moving Expenses

Clause 31

ITA
62(1)

Section 62 of the Act provides a deduction for qualifying moving expenses. The requirement that the distance between the old residence and the new work location be at least 25 miles greater than the distance between the new residence and the new work location has been changed to the metric equivalent—40 kilometres. This change applies to relocations occurring after 1981.

Reserve on Disposition of Resource Properties

ITA
64

Clause 32

Section 64 of the Act permitted the deduction of a reserve in respect of the disposition of a resource property for an amount included in income but not due until a later year. Section 64 is repealed. As a consequence, a reserve may not be claimed with respect to dispositions occurring after November 12, 1981 except under the terms in existence on November 12, 1981 of an offer or agreement in writing made or entered into on or before that date.

Clause 33

Subclauses 33(1) and (2)

ITA
66(11)

Subsection 66(11) of the Act provides rules limiting the deduction of certain exploration, development and resource property expenses where control of a corporation changes after the corporation ceased to carry on an active business. This subsection is amended so that it will apply only to a change of control before November 13, 1981. New rules apply after that date.

ITA
66(11.1)

The Act provides successor rules that allow the unused exploration, development or resource property expenses of one corporation to continue to be deducted by another corporation (the "successor corporation") which acquires all or substantially all the assets used by the first corporation in its resource business. The expenses that are passed on to a successor corporation or second successor corporation may be deducted only against resource income from assets acquired from the original corporation.

Subsection 66(11.1) is a new provision which applies after November 12, 1981 where control of a corporation changes or where a corporation ceases to be tax-exempt. It applies to exploration, development and resource property expenses made or incurred by the corporation before the change in control or change in tax status and, by making the successor rules apply, restricts the deductibility of such expenses to resource income from assets held immediately before the change of control or change in tax status.

ITA
66(11.2)

If a corporation to which subsection 66(11.1) applies later transfers all or substantially all of its resource business assets to another corporation (for example, on an amalgamation) so that the successor rules apply, subsection 66(11.2) provides that the corporation acquiring those assets will be treated as a successor corporation, rather than as a second successor corporation, in respect of the expenses of the original corporation to which subsection 66(11.1) applies. Thus, the restrictions that applied to the deduction of such expenses by the original corporation will continue to apply to the deduction of such expenses by the successor corporation.

ITA
66(11.3)

In determining the date of a change in control for the purposes of subsections 66(11) and (11.1) of the Act, the new subsection 66(11.3) provides that a change in control after November 12, 1981 and before 1983 by reason of a share acquisition pursuant to an agreement in writing concluded on or before November 12, 1981 will be considered a change in control on or before November 12, 1981.

These amendments apply to taxation years ending after November 12, 1981.

Subclause 33(3)

ITA
66(15)(g.1)

Paragraph 66(15)(g.1) of the Act defines an oil or gas well. The definition is amended to clarify that a well does not include an exploratory probe. The cost of such probes generally qualifies as a Canadian exploration expense under subparagraph 66.1(6)(a)(i) of the Act. The revised definition also clarifies that paragraph 66.2(5)(a) of the Act, which treats the cost of drilling an oil or gas well as a Canadian development expense, will not apply to an exploratory probe. This amendment applies after 1980.

Subclause 33(4)

ITA
66(15)(g.3)

Under paragraph 98(3)(d) of the Act, a designated amount can be added to the cost of a Canadian or foreign resource property acquired by a partner on the dissolution of a partnership. Paragraph 66(15)(g.3) is a new provision which clarifies that an amount so designated will be regarded as "an outlay" or "expense" made or incurred for purposes of sections 66, 66.1, 66.2 and 66.4 of the Act.This amendment applies after 1980.

Subclauses 33(5) and (6)

These set out the effective dates for the amendments to section 66 of the Act.

Canadian Exploration Expense

Clause 34

Subclauses 34(1), (2) and (3)

ITA
66.1(6)(a)(ii), (ii.1) and (ii.2)

Paragraph 66.1(6)(a) of the Act defines Canadian exploration expense. This paragraph was previously amended to establish new rules for determining those expenses incurred after 1981 in drilling an oil or gas well that qualify as Canadian exploration expenses. Subparagraphs 66.1(6)(a)(ii), (ii.1) and (ii.2) are amended so that the revised definition will not apply for expenses incurred before 1984. Thus, expenses incurred during 1982 and 1983 in drilling a well which does not go into commercial production within 12 months of completion will be included in the definition of Canadian exploration expense. The expenses incurred after 1983 in drilling such a well will ordinarily be treated as a Canadian development expense.

Subclause 34(4)

ITA
66.1(6)(a)(v)

Subparagraph 66.1(6)(a)(v) of the Act relates to what are commonly referred to as "flow-through" shares. This provision permits Canadian exploration expenses to be deducted by a taxpayer who incurs the expenses pursuant to an agreement with a corporation under which the expenses were incurred solely as consideration for shares of the corporation. This subparagraph is amended to provide the flexibility to exclude shares that may be prescribed. Similar amendments are proposed to subparagraphs 66.2(5)(a)(v) and 66.4(5)(a)(iii) of the Act relating to shares issued as consideration for Canadian development expenses and Canadian oil and gas property expenses. This amendment will apply to any outlay or expense made or incurred after 1982.

Subclauses 34(5) and (6)

These set out the effective dates for the amendments to section 66.1 of the Act.

Canadian Development Expenses

Clause 35

Subclause 35(1)

ITA 66.2(5)(a)(v)

Subparagraph 66.2(5)(a)(v) of the Act permits Canadian development expenses to be deducted by a taxpayer who incurs the expenses pursuant to an agreement with a corporation under which the expenses were incurred solely as consideration for shares of the corporation. This subparagraph is amended so that it will not apply where shares are prescribed shares. This amendment is similar to that made to subparagraph 66.1(6)(a)(v) of the Act relating to "flow-through" shares issued as consideration for exploration expenses. This amendment applies to any outlay or expense made or incurred after 1982.

Subclause 35(2)

ITA 66.2(5)(b)(x)

Paragraph 66.2(5)(b) of the Act defines cumulative Canadian development expense ("CCDE"). In determining at any time the balance in the CCDE account of a taxpayer, various amounts are deducted from the aggregate Canadian development expenses. One such deduction is the amount by which the sale proceeds of Canadian oil and gas properties exceed the unclaimed balance of the taxpayer's cumulative Canadian oil and gas property expense ("CCOGPE") account. Thus, the proceeds of the sale of a Canadian oil and gas property are applied, firstly, against any unclaimed balance in the CCOGPE account and, secondly, against any unclaimed balance in the CCDE account.

Under the existing Act, when a successor corporation sells an oil and gas property acquired from a predecessor, the sale proceeds are applied, firstly, to reduce the unclaimed balance of the predecessor's CCOGPE account, secondly, to reduce the unclaimed balance of the successor's CCOGPE account and, thirdly, to reduce the unclaimed balance of the successor's CCDE account. No recognition is given to the fact that there may be a balance remaining in the predecessor's CCDE account.

Subparagraph 66.2(5)(b)(x) is amended to remedy this unintended result. The effect of this amendment is that, upon the disposition of a Canadian oil and gas property acquired from a predecessor, the proceeds are applied, firstly, to reduce the unclaimed balance of the predecessor's CCOGPE account and, secondly, to reduce the unclaimed balance of the successor's CCOGPE account. Thereafter, to the extent the proceeds exceed the successor's CCOGPE account, the excess reduces the successor's CCDE account, but only after recognition has been given to the unclaimed balance of the predecessor's CCDE account. There is no reduction in the predecessor's CCDE account, but the balance remaining in that account at any particular time is reflected in subparagraph 66.2(5)(b)(x) so as to reduce the amount to be deducted from the successor's CCDE account as the result of sales of Canadian oil and gas properties. This amendment applies to taxation years ending after December 11, 1979.

Subclauses 35(3) and (4)

These set out the effective dates for the amendments to section 66.2 of the Act.

"Flow-Through" Shares

Clause 36

ITA
66.3

"Flow-through" shares of the capital stock of a corporation are those issued to a taxpayer as consideration for exploration, development or Canadian oil and gas property expense he has incurred. Section 66.3 of the Act deems such shares not to be capital property but to be inventory acquired at a nil cost. This means that the proceeds on the sale of "flow-through" shares are fully taxable as income. The section is amended to remove the requirement to treat such shares acquired by a taxpayer after November 12, 1981 as inventory. The ordinary rules will apply for determining whether such shares are capital property or inventory in the hands of the shareholder. Normally, in computing income for a taxation year, up to 10% of a taxpayer's cumulative Canadian oil and gas property expense and up to 30% of his cumulative Canadian development expense may be deducted. Where "flow-through" shares are inventory in the hands of the shareholder, his cumulative Canadian oil and gas property expense and cumulative Canadian development expense may be deducted to the full extent of any income inclusion resulting from a disposition of the shares, without being affected by the normal 10% and 30% limitations. Where "flow-through" shares are capital property in the hands of the shareholder, the normal 10% and 30% rules will apply to limit the amount of cumulative Canadian oil and gas property expense and cumulative Canadian development expense that may be deducted to offset the income inclusion arising on a disposition of the shares.

Canadian Oil and Gas Property Expenses

Clause 37

ITA
66.4(5)(a)(iii)

Subparagraph 66.4(5)(a)(iii) of the Act permits Canadian oil and gas property expenses to be deducted by a taxpayer who incurs the expenses pursuant to an agreement with a corporation under which the expenses were incurred solely as consideration for shares of the corporation. This subparagraph is amended so that it will not apply where the shares are prescribed shares. This amendment is similar to the amendments to subparagraphs 66.1(6)(a)(v) and 66.2(5)(a)(v) of the Act relating to shares issued as consideration for exploration and development expenses. This amendment applies to any outlay or expense made or incurred after 1982.

Inadequate Consideration

Clause 38

Subclause 38(1)

ITA
69(5)(d)

Subsection 69(5) of the Act sets out rules to ensure that, where property is appropriated to a shareholder on the winding-up of a corporation, the transfer of property is to be treated as having been effected at fair market value with the consequent recognition of any resulting income or loss on the transfer. For this purpose, paragraph 69(5)(d) provides that the stop-loss rule in subsection 85(4) of the Act will not apply to such a transfer of property. Paragraph 69(5)(d) is amended to include a reference to new subsection 85(5.1) which is a new loss limitation rule that applies to certain transfers of depreciable property after November 12, 1981.

Subclauses 38(2) and (3)

ITA
69(7.1) and (11)

Section 69 of the Act is also amended by adding two new subsections that deal with sales of aviation turbine fuel. Subsection 69(7.1) requires a vendor of aviation turbine fuel used on an international flight to include a prescribed amount in income in addition to the actual sale proceeds. The prescribed amount is set for each month by regulation. This rule will not apply to sales of fuel for an aircraft having a maximum take-off weight of 34,000 kilograms or less.

The sale price of aviation turbine fuel for international flights is based on international fuel prices that are higher than domestic prices. The amount of the special addition to income is designed to provide an after-tax return to suppliers on such sales equal to that on fuel sold on domestic flights.

Subsection 69(11) describes the circumstances in which aviation turbine fuel will be regarded as being used on an international flight for the purposes of the special addition to income.

Subsections 69(7.1) and (11) apply to dispositions of fuel after January 31, 1982.

Subclauses 38(4) and (5)

These set out the effective dates for the amendments to section 69 of the Act.

Death of a Taxpayer

Clause 39

Subclause 39(1)

ITA
70(1)

Under subsection 70(1) of the Act, periodic payments such as interest and rent are deemed to accrue daily to the date of death and the accrued amount is required to be included in the deceased's income. Subsection 70(1) is amended to clarify that the reference therein to an annuity does not include an interest in those annuity contracts whose tax consequences are set out in paragraph 148(2)(b) of the Act. This amendment applies after November 12, 1981.

Subclause 39(2)

ITA
70(3.1)

Under subsection 70(2) of the Act, the value of "rights or things" owned by a taxpayer at his death is required to be included in his income for his final taxation year, unless they are transferred to a beneficiary within a specified time after death and included in the beneficiary's income. Subsection 70(3.1) excludes certain "rights or things" from this treatment. This subsection is amended to specifically exclude life insurance policies since their taxation on death is now dealt with in section 148 of the Act. In the case, however, of an annuity contract which the taxpayer purchased for an amount which was deductible under paragraph 60(l), "rights or things" treatment is available. This amendment applies after November 12, 1981.

Subclause 39(3)

ITA
70(5.3)

Under subsection 70(5) of the Act, a taxpayer is treated as having disposed immediately before his death of any shares of the capital stock of a corporation for proceeds equal to their fair market value at that time. Similar fair market value determinations are required for the purposes of subsections 70(9.4) and (9.5) of the Act. Subsection 70(5.3) is added to the Act to provide that, in determining the fair market value of shares for these purposes, any life insurance policy on the deceased under which the corporation is a beneficiary is to be valued at its cash surrender value. This amendment applies to deaths occurring after December [illegible]1, 1982.

Subclauses 39(4), (5) and (6)

ITA
70(6)

Subsection 70(6) of the Act permits property to be transferred or distributed on death to a spouse or a qualifying spousal trust on a tax-deferred "rollover" basis. Paragraph 70(6.1)(b) of the existing Act provided that a trust created as a result of a disclaimer by a beneficiary of the deceased would constitute a qualifying spousal trust. This provision is now to be reflected in subsection 70(6) which is amended to refer specifically to a transfer or distribution of property as a consequence of a disclaimer or renunciation under a will or on an intestacy. Accordingly, the spousal rollover under subsection 70(6) is now available where the spouse or spousal trust acquires the property, whether under a will or on an intestacy, as a result of a disclaimer or renunciation.

ITA
70(6.1)

As a consequence of the change to subsection 70(6) of the Act, paragraph 70(6.1)(b) is repealed and paragraph 70(6.1)(c) is renumbered as paragraph 70(6.1)(b).

ITA
70(6)(f)

Paragraph 70(6)(f) is added to the Act as a result of the amendment to the opening words of subsection 70(6). The new paragraph clarifies that a renunciation which results in property being transferred or distributed to a spouse or spousal trust is not, by itself, considered to be a disposition of property. These amendments are applicable after 1980.

Subclauses 39(7) and (8)

ITA
70(10) and (11)

Subsections 70(10) and (11) of the Act are amended as a consequence of the changes to the provisions relating to capital gains reserves. Sections 40 and 44 of the Act provide for a reserve over a maximum of 10 years where a taxpayer disposes of a share of the capital stock of a family farm corporation, an interest in a family farm partnership or a share of the capital stock of a small business corporation to his child. The amendments to subsections 70(10) and (11) provide that the definitions of these terms apply for purposes of sections 40 and 44. These amendments apply, subject to certain transitional provisions, to dispositions occurring after November 12, 1981.

Subclauses 39(9) to (12)

These set out the effective dates for the amendments to section 70 of the Act.

Reserves for the Year of Death

Clause 40

ITA 72(2)(c)

Section 72 of the Act provides rules for dealing with certain reserves in the year of a taxpayer's death. No reserve is allowed as a deduction in the taxpayer's final year except where an amount receivable is transferred in consequence of the taxpayer's death to the taxpayer's spouse or to a spousal trust and the appropriate election is made. In these circumstances there is, essentially, a "rollover" of the reserves from the taxpayer to the spouse or spousal trust. This amendment, which adds new paragraph 72(2)(c) to the Act, is consequential on the changes to the provisions relating to reserves in sections 20, 40 and 64 of the Act. By virtue of these changes, a three-year reserve mechanism is provided on the disposition of property sold in the course of a business, a five-year and in certain cases a ten-year reserve mechanism is provided on the disposition of capital property, and no reserve is provided on the disposition of a resource property.

This amendment ensures that, where an election is made with respect to the transfer of an amount receivable from a deceased taxpayer to his spouse or to a spousal trust, the reserve limitations and any relieving transitional provisions which would have applied to the deceased had he not died will continue to apply. This amendment applies after November 12, 1981.

***Inter Vivos* Transfers of Property**

Clause 41

ITA
73(1.2)

Subsection 73(1) of the Act permits a taxpayer to transfer property on a tax-deferred "rollover" basis to a spouse or former spouse or to a trust on that person's behalf. The definitions of "spouse" and "former spouse" are defined for this purpose in subsection 73(1.2) to include a party to a void or voidable marriage. Subsection 73(1.2) is repealed and is replaced by new subsection 252(3) which, for the purposes of a number of provisions of the Act including subsection 73(1), provides the same definitions. This amendment applies after 1981.

Foreclosures and Repossessions

Clause 42

ITA
79(f)

Section 79 of the Act provides special rules where a creditor acquires or reacquires property in consequence of the debtor's failure to pay all or part of a mortgage or other debt. Under the existing provision, the cost to the creditor of the repossessed property is determined on the basis of the principal amount of the indebtedness notwithstanding that the creditor may have acquired the debt obligation from a third party for less than its principal amount. The amendment to paragraph 79(f) ensures that the cost of the property to the creditor is determined on the basis of the cost to him of the debt obligation. This amendment applies with respect to acquisitions and reacquisitions of property after November 12, 1981.

Gain on the Settlement of a Debt Obligation

ITA
80

Clause 43

Section 80 of the Act sets out the rules that apply where a debt owed by a taxpayer is settled or extinguished for less than its principal amount. Ordinarily the resulting gain is not taxable as such but reduces the losses which may be carried over to other taxation years. Any excess reduces the cost of depreciable property and other capital property. This section is now renumbered as subsection 80(1) and subsections 80(2) and (3) are added to the Act to provide separate rules where a debt owing by one corporation to another is settled or extinguished as a result of an amalgamation or a winding-up.

Under new subsection 80(2), a debt settled or extinguished upon the amalgamation of the debtor and creditor corporations is deemed to have been settled before the amalgamation for its cost amount. Cost amount for this purpose is determined according to the definition of "cost amount" in section 248 of the Act but without reference to paragraph (e) of the definition. In the case of a debt that is capital property of the creditor, its cost amount will be its adjusted cost base and, in the case of a debt that is inventory, its cost amount will be its inventory value as determined for the purpose of computing the creditor's income. Accordingly, if the debt had been purchased by the creditor from a third party for an amount less than both its principal amount and the amount for which it was issued by the debtor, the rules in subsection 80(1) of the Act may apply on an amalgamation of the debtor and creditor to reduce the debtor's loss carryovers or cost of depreciable and other capital property.

Under new subsection 80(3), where a debt owed to a parent corporation by its subsidiary is settled or extinguished on the winding-up of the subsidiary under subsection 88(1) of the Act for less than both the principal amount of the debt and its cost amount to the parent, an election may be filed by the parent corporation to deem the debt to have been settled for its cost amount. Again, cost amount is given the special meaning referred to above. As in the case of an amalgamation, where this amount is less than both the principal amount of the debt and the amount for which it was issued by the subsidiary, the forgiveness of debt rules in subsection 80(1) may apply to the subsidiary.

Subsections 80(2) and 80(3) apply to amalgamations and windings-up occurring after November 12, 1981.

Clause 44

Subclauses 44(1) and (2)

ITA 80.4

Subsection 80.4(1) of the Act, as amended, provides that where any person or partnership received a loan or otherwise incurred a debt by virtue of an individual's employment or intended employment or by virtue of the performance of services by a corporation that carries on a personal services business, the individual or the corporation is deemed to have received a benefit in a taxation year. The benefit is measured as the difference between the amount of interest for the year that would be payable on the indebtedness if interest thereon were calculated at the prescribed rate and the amount of interest that is actually paid in the year or within 30 days after the end of the taxation year.

Subsection 80.4(2) of the Act as amended provides a similar rule in respect of indebtedness extended by a corporation to a shareholder of the corporation, a person who does not deal at arm's length with a shareholder of the corporation, or a person who was a member of a partnership or a beneficiary of a trust that was a shareholder of the corporation. Where the loan or indebtedness was extended by virtue of such shareholding, a benefit is deemed to be received by the debtor. The benefit is measured in essentially the same manner as for an employee.

Subsection 80.4(3) of the Act provides a number of exclusions from the rules set out in subsections 80.4(1) and (2). Paragraph (a) thereof provides that a benefit will not arise where the rate of interest payable on the debt is equal to or greater than the rate of interest that would have been agreed upon in an arm's length transaction at the time the obligation was incurred. However, this exception will not apply in those circumstances where any interest on the debt is paid to the creditor by a party other than the debtor. Paragraph 80(3)(b) provides that no benefit will be attributed to a loan or debt that was included in the income of the debtor.

Subsection 80.4(4) of the Act provides a special rule in computing the benefit in respect of a home purchase loan received by virtue of an office or employment. This rule provides that in computing the benefit under subsection 80.4(1), the prescribed rate in effect at any time during the year may not exceed the prescribed rate that was in effect at the time the home purchase loan was made. This rule, when read in conjunction with subsection 80.4(6), provides that any increase in the prescribed rate of interest that occurs within the five-year period from the date the home purchase loan was received or was last deemed to be received will not increase the amount of the benefit computed under subsection 80.4(1), whereas any decrease in the prescribed rate from the prescribed rate in effect at the time the loan was made will reduce the amount of the benefit.

Subsection 80.4(5) provides transitional relief to employees who had received a housing loan before November 13, 1981 or had made arrangements in writing before that date to obtain a housing loan. For 1982 the amount of all such loans to an employee or his spouse is to be reduced by $40,000 for the purpose of calculating the interest benefit. For 1983 the reduction is $20,000. Since the amount of the benefit is calculated on the outstanding balance of any loan, the effect of these reductions is to reduce the amount required to be included in income as a benefit in those two years.

Subsection 80.4(6) of the Act provides that where a home purchase loan has a term of repayment in excess of five years, it is treated as a new loan every five years. This subsection, taken together with subsection 80.4(4), means that the benefit on a home purchase loan is determined for the first five-year period by reference to the prescribed rate when the loan was made. At the expiry of one five-year period, the benefit for the next five-year period will be measured in relation to the prescribed rate in effect at that time.

Subsection 80.4(7) of the Act provides definitions of the expressions "home purchase loan" and "prescribed rate" of interest. The prescribed rate of interest is the basis for calculating the benefit under subsections 80.4(1) and (2) on employee and shareholder loans. The rate is fixed at 6% before 1978, at 8% for 1978 and at 16% for a home purchase loan received after November 12, 1981 and before 1982. Since 1981 the prescribed rate has been determined quarterly by reference to the rate on 90-day Treasury bills. For the last quarter of 1982 the rate is 16% and for the first quarter of 1983 it will be 12%.

Subsection 80.4(8) of the Act provides that for the purpose of determining the benefit under subsection (2) to a debtor by virtue of a shareholding, a person will be treated as being connected with a shareholder where that person does not deal at arm's length with the shareholder.

These amendments to section 80.4 apply to taxation years ending after 1981.

Subclause 44(3)

ITA
80.4(1)(d)
80.4(2) (a) and (b)

Subclause 44(3) of the Bill amends paragraphs 80.4(1)(d), 80.4(2)(a) and 80.4(2)(b) of the Act for the 1980 and 1981 taxation years. These changes are necessary to pick up the appropriate references to paragraph 80.4(1)(a.1) of the Act which were inadvertently omitted when that paragraph was introduced.

Deemed Interest Expense

Clause 45

ITA 80.5

This amendment adds new subsection 80.5 to the Act. It provides that where a benefit is included in the income of a taxpayer under section 80.4 in respect of employee or shareholder debt, the amount of the benefit will be regarded as an interest expense of the debtor for purposes of the rules relating to the deduction of interest under paragraph 20(1)(c) of the Act. Thus, where the debtor uses the borrowed funds for the purpose of earning income from a property or business—for example, for investing in shares or other securities—he will be able to claim an offsetting deduction in calculating his income. This amendment applies to taxation years commencing after 1981.

Amounts Not Included in Income

Clause 46

Subclauses 46(1), (2) and (3)

ITA 81(1)(a), (h) and (j)

Subsection 81(1) of the Act lists various amounts which are not included in computing income. The amendment to paragraph 81(1)(a) and the repeal of paragraphs 81(1)(h) and (j) exclude from the category of exempt income amounts received or receivable by an individual that are exempt from income tax by virtue of a tax treaty, workmen's compensation payments and social assistance payments. The result of these amendments, taken together with amendments to section 56 of the Act, is that these amounts will be included in income. The income inclusion is principally relevant for purposes of determining whether the recipient qualifies as a dependant of another taxpayer for the purposes of a deduction under section 109 of the Act. Any amount included in income by virtue of these amendments will be deductible in computing taxable income by virtue of the amendments to paragraph 110(1)(f) of the Act. These amendments apply to the 1982 and subsequent taxation years.

Subclause 46(4)

ITA 81(3.1)

Subsection 81(3.1) of the Act excludes from income certain amounts received by a part-time employee in respect of travelling expenses. The amendment to this subsection converts the measurement unit referred to therein to its metric equivalent. The reference to "80 kilometres" replaces the former reference to "50 miles". This amendment applies with respect to travelling expenses incurred after 1981.

Subclauses 46(5) and (6)

These set out the effective dates for the amendments to section 81 of the Act.

Life Insurance Capital Dividends

Clause 47

ITA
83(2.1)

Subsection 83(2.1) is a new provision that sets out the treatment of dividends paid out of the "life insurance capital dividend account" of a corporation. The definition of this expression is provided in paragraph 89(1)(b.2) of the Act. A portion of the life insurance proceeds arising on the death of a person and received by a corporation may be distributed tax-free to its shareholders to the extent the proceeds were included in the life insurance capital dividend account of the corporation. Under subsection 83(2.1), where a private corporation pays a dividend to its shareholders after June 28, 1982 and has made the appropriate election, the full amount of the dividend will be considered to be a life insurance capital dividend. As such, it will not be included in the income of the shareholder. The election must be filed before the dividend becomes payable or is paid, or before June 30, 1983 if that is later. Subsection 83(2.1) applies to dividends paid after June 28, 1982.

ITA
83(3)

Subsection 83(3) permits the late filing of an election in respect of a capital dividend. Subsection 83(3) is amended so that the procedure for making such elections is extended to life insurance capital dividends. This amendment applies after June 28, 1982.

Deemed Dividends

Clause 48

ITA
84(8)

A shareholder is deemed under section 84 of the Act to have received a dividend as a result of certain corporate transactions. The transactions that give rise to a deemed dividend are described in subsection 84(1) (increase in paid-up capital of shares), subsection 84(2) (winding-up distribution), subsection 84(3) (redemption of shares) and subsection 84(4) (reduction of paid-up capital of shares). Subsection 84(8) is added to the Act to deem a dividend not to have been received by virtue of subsections 84(1) to (4) by a shareholder of a public corporation. It does not apply, however, to a shareholder who is a non-resident, a resident not dealing at arm's length with the corporation or a private corporation. Exceptions are also provided where the dividend was received in the course of a "butterfly" reorganization or where the dividend is received by a corporation and cannot be deducted in computing its taxable income.

New subsection 84(8) provides that, although the corporation is deemed to have paid a dividend, the shareholder is not deemed to have received a dividend. As a result, where the shareholder receives an amount in respect of a share redemption or other disposition transaction described in section 84, the amount will constitute proceeds of disposition of his shares under paragraph 54(h) of the Act and a gain or loss may result. In most other circumstances, where the dividend does not constitute proceeds of disposition, the adjusted cost base of his shares will be reduced under subparagraph 53(2)(a)(ii) or (iv) of the Act.

In the absence of subsection 84(8) of the Act, a taxpayer could obtain an inintended tax advantage by acquiring a share on the open market just before its redemption or cancellation, with the result that he would receive a substantial portion of his cost in a form that would qualify for the favourable tax consequences available for dividends—for example, the dividend tax credit in the case of an individual. The remainder of the return would be treated as proceeds of disposition of the share. This would give rise to a capital loss for tax purposes and for many taxpayers the tax benefit resulting from the loss would exceed any additional tax payable on the dividend.

This amendment applies with respect to dividends paid after November 12, 1981.

Clause 49

ITA
84.1(1)(b)(ii)

The purpose of section 84.1 of the Act is to prevent a shareholder from extracting on a tax-free basis the value of his shares at the end of 1971 by means of a transfer of the shares to a corporation with which the taxpayer does not deal at arm's length. In the typical case, the shares of an operating company would be transferred to a new holding company followed by a dividend from the operating company to enable the holding company to fund the purchase price of the shares. Since dividends between corporations are generally not subject to tax, the pre-1972 earnings could in this way be realized by the shareholder in the form of a capital gain. Even though the transaction is in substance a surplus distribution, to the extent that the gain accrued before 1972 it would not be taxable. Section 84.1 is designed to counter this opportunity to avoid tax on the distribution of pre-1972 earnings. This is accomplished by requiring the shareholder on a sale of shares to a related company to recognize a gain or to reduce the adjusted cost base of any debt or shares received in consideration of the sale.

The adjusted cost base reduction depends, in part, upon the paid-up capital of any shares of the purchaser corporation taken back by the taxpayer. The paid-up capital of a share is calculated by dividing the aggregate paid-up capital of the class of shares to which the share belongs by the number of issued and outstanding shares of that class. Therefore, where shares of the same class as those taken back in consideration of the transfer were outstanding at the time of the transfer, it was possible to largely avoid the application of section 84.1 since the increase in paid-up capital would be averaged over all outstanding shares.

The amendment to subparagraph 84.1(1)(b)(ii) removes this method for avoiding the application of section 84.1 by requiring the shareholder to reduce the adjusted cost base of any consideration received on the transfer of his shares by the total increase in the paid-up capital of all shares of the purchaser corporation as a consequence of the transfer. This amendment applies to dispositions occurring after November 12, 1981.

Transfers of Depreciable Property

ITA
85(5) and (5.1)

Clause 50

Subsection 85(5) of the Act is amended and subsection 85(5.1) is added to the Act to extend the loss limitation rules provided in subsection 85(4) of the Act. The new subsection 85(5.1) applies to transfers of depreciable property of a prescribed class and has a broader application than subsection 85(4) in that it applies, not only in respect of transfers to a corporation, but also in respect of transfers to certain other persons and partnerships. However, it applies only where the fair market value of the depreciable property is less than both its cost and its proportionate share of the undepreciated capital cost of all property of the class.

New subsection 85(5.1) applies on the transfer, within a specified group of persons, of depreciable property of a prescribed class to deny or reduce the terminal loss or, where the property transferred is not the last property in the class, to reduce the future capital cost allowance available in respect of the remaining property of the class.

Where a transfer of property falls within subsection 85(5.1), the rules set out in paragraphs (d) to (g) thereof apply. Paragraph (d) ensures that there is no conflict between the rules contained in subsections 85(1) and (2) and section 97 of the Act and those contained in subsection 85(5.1). Paragraph (e) provides for the calculation of the transferor's proceeds of disposition of the property and the transferee's cost thereof. The transferor's proceeds of disposition of any property are deemed to be the lesser of its cost and its proportionate share of the undepreciated capital cost of the prescribed class to which the property belongs. The amount treated as the transferor's proceeds of disposition is deemed to be the cost of the property to the transferee. Paragraph (f) provides for an ordering where two or more properties of a class are disposed of at the same time and is similar to paragraph 85(1)(e.1) of the Act. Paragraph (g) is similar to paragraph 85(1)(f) and provides that the cost to the transferor of property received in consideration of the disposition is the lesser of the fair market value of the property received and the pro rata share of the fair market value of the property transferred.

The amendment to subsection 85(5) of the Act is consequential on the introduction of new subsection 85(5.1). Where subsection 85(5.1) has applied and the capital cost to the transferor of the property transferred exceeds its proceeds of disposition, for the purposes of section 13 (recapture) and section 20 (capital cost allowance) the transferee's capital cost of the property is deemed to be equal to the transferor's capital cost, and the difference is deemed to have been claimed by the transferee as capital cost allowance and is, therefore, potentially subject to recapture on a subsequent disposition.

The amendment to subsection 85(5) of the Act and the introduction of subsection 85(5.1) apply with respect to dispositions of property occurring after November 12, 1981, except where the disposition was pursuant to a written agreement entered into on or before that date.

Disposition of Shares of a Foreign Affiliate

ITA 85.1(4)

Clause 51

Subsection 85.1(3) of the Act permits a taxpayer to transfer the shares of a foreign affiliate to another foreign affiliate on a tax-deferred "rollover" basis. Subsection 85.1(4) is added to the Act as an anti-avoidance provision. It provides that the rollover in subsection 85.1(3) will not apply where a share of one foreign affiliate, which was transferred to a second foreign affiliate, is subsequently sold as part of the series of transactions to an arm's length party if substantially all of the first affiliate's property is excluded property. Excluded property is defined in paragraph 95(1)(a.1) of the Act and, in general terms, means property used in an active business and shares of another affiliate substantially all of whose property is excluded property.

The rule is necessary because, if the share of the transferred affiliate is excluded property to the transferee affiliate, the amendment to the definition of foreign accrual property income would permit the transferee affiliate to resell the share to an arm's length party without giving rise to foreign accrual property income. The gain on the resale would be included in the transferee affiliate's surplus accounts and would not be subject to Canadian tax until subsequently received by the Canadian shareholder by way of dividend. By denying the initial rollover under subsection 85.1(3), any taxable capital gain on the initial transfer will be included under section 91 of the Act in the income of the Canadian shareholder.

This amendment applies to dispositions occurring after November 12, 1981.

Amalgamations

Clause 52

Section 87 of the Act provides rules which apply on the amalgamation of two or more taxable Canadian corporations. The amalgamated corporation is generally treated as a continuation of the predecessor corporations for the purposes of the Act. There are a number of amendments to section 87 that are consequential on amendments to other sections of the Act.

Subclause 52(1)

ITA
87(1.2)(a)

On an amalgamation, the amalgamated corporation can deduct the exploration, development and resource property expenses of the predecessor corporations but only within the limits imposed by the first and second successor corporation rules. Subsection 87(1.2) applies to the amalgamation of a parent corporation and its wholly-owned subsidiary and permits the resulting new corporation to elect that the successor corporation rules apply only to the exploration, development and resource property expenses of the subsidiary. Where the election is made, the parent corporation's expenses would not be restricted as a result of the amalgamation. Paragraph 87(1.2)(a) is amended to clarify that where the parent corporation is itself a first or second successor corporation the amalgamation will not further restrict the deduction of the expenses which the parent was entitled to deduct as a successor corporation. This amendment applies to amalgamations occurring after December 14, 1975.

Subclause 52(2)

ITA
87(1.3) and (1.4)

The rules of the Act relating to joint exploration corporations permit certain exploration, development and resource property expenses of a joint exploration corporation to be renounced in favour of a shareholder corporation and to be treated as expenses incurred by the shareholder corporation. Subsection 87(1.3) is a new provision which provides that where there has been an amalgamation of a parent corporation and a wholly-owned subsidiary, the amalgamated corporation is deemed to be a shareholder of a joint exploration corporation where the parent was itself a shareholder before the amalgamation took place. This amendment permits the amalgamated corporation to claim the exploration, development and resource property expenses that had been renounced by the joint exploration corporation in favour of the shareholder corporation. This amendment will give the amalgamated corporation the same status as the parent had before the amalgamation.

Existing subsection 87(1.3), which defines the term "subsidiary wholly-owned corporation", is renumbered as subsection 87(1.4) and is amended to include a reference to new subsection 87(1.3).

These amendments apply to amalgamations occurring after December 14, 1975.

Subclause 52(3)

ITA
87(2)(j.4)

Paragraph 87(2)(j.4) provides that an amalgamated corporation is deemed to be a continuation of its predecessor corporations for certain provisions of the Act relating to accrued income on debt obligations and annuity contracts and adjustments to the cost base of life insurance policies. This paragraph is amended to reflect changes in the Act relating to the accrual rules. This amendment applies after December 1, 1982.

ITA
87(2)(j.5)

Paragraph 87(2)(j.5) is added to the Act to provide that an amalgamated corporation is deemed to be a continuation of its predecessor corporations for purposes of the provisions of the Act relating to lease cancellation payments in paragraphs 20(1)(z) and (z.1) of the Act. This amendment applies to payments relating to lease cancellations occurring after November 12, 1981, other than a cancellation pursuant to an agreement in writing entered into on or before that date.

Subclause 52(4)

ITA
87(2)(v)

Paragraph 87(2)(v) of the Act provides that charitable donations, gifts to Her Majesty and gifts to certain cultural institutions made by a predecessor corporation are deemed to have been made by the amalgamated corporation. This paragraph is amended as a result of the amendments to paragraphs 110(1)(a), (b) and (b.1) of the Act which allow a carry-forward of deductions for such donations and gifts for a period of up to five years. This amendment applies to such gifts made in 1981 and subsequent taxation years.

Subclause 52(5)

ITA
87(2)(y)

Paragraph 87(2)(y) of the Act provides for the determination of the cumulative deduction account of an amalgamated corporation. This paragraph is amended by adding the word "all" in the expression "the aggregate of all amounts" and deleting the words "for the purposes of subsection 125(12)". This amendment ensures that the new corporation is deemed for all purposes of section 125 of the Act to be the same corporation as, and a continuation of, all predecessor corporations. The amendment is consequential on the amendments to subsections 125(8.1) through (8.6) of the Act, and is applicable to taxation years ending after 1982.

ITA
87(2)(y.1)

Paragraph 87(2)(y.1) is added to the Act as a consequence of the introduction of the corporate distributions tax in Part II of the Act. This paragraph provides that the net "preferred-earnings amount" of each predecessor corporation is added to the preferred-earnings amount of the amalgamated corporation. "Preferred-earnings amount" is defined in subsection 181(2) of the Act and is a measure of a corporation's taxable business income earned after 1982 that was subject to the reduced small business rate of tax. Dividends paid out of the preferred-earnings amount are subject to a 12.5% corporate distributions tax. This amendment applies to taxation years commencing after 1982.

Subclause 52(6)

ITA 87(2)(z.1)

Paragraph 87(2)(z.1) of the Act provides that the capital dividend accounts of all predecessor corporations enter into the calculation of the capital dividend account of the amalgamated corporation. This paragraph is amended to extend the same treatment on an amalgamation to the new life insurance capital dividend account as defined in paragraph 89(1)(b.2) of the Act. This amendment applies after June 28, 1982.

Subclause 52(7)

ITA 87(2)(ll)

Paragraph 87(2)(ll) is added to the Act as a result of the amendments to the provisions of the Act relating to reserves in subsection 20(8), subparagraph 40(1)(a)(iii) and subsection 40(1.1) of the Act. The new paragraph puts the amalgamated corporation in the same position in relation to such reserves as its predecessors. This amendment applies after November 12, 1981.

ITA 87(2)(mm)

Paragraph 87(2)(mm) is added to the Act so that the transitional relief relating to professional work in progress set out in subsection 10(6) of the Act, available to a predecessor corporation for the 1983 taxation year, will be available to the amalgamated corporation.

Subclause 52(8)

ITA 87(8)

On a merger of two or more foreign affiliates of a taxpayer, subsection 87(8) of the Act provides that the shares of a predecessor corporation that are exchanged for the shares of the merged entity may be "rolled over" on the same basis as applies to an amalgamation of taxable Canadian corporations. Subsection 87(8) is amended to make the rollover elective and to extend the provisions of the subsection to shares of any non-resident corporation that undergoes a foreign merger with another non-resident corporation.

ITA 87(8.1)

Subsection 87(8.1) is a new provision which adds a definition of the term "foreign merger" for the purposes of sections 87 and 95 of the Act. A foreign merger is defined as a merger or combination of two or more non-resident corporations to form one corporation resident in the same country as all the predecessors, provided that two conditions are satisfied: first, that all or substantially all of the property and liabilities of each predecessor corporation becomes the property and liabilities of the new corporation and, second, that all or substantially all of the shares of the capital stock of the predecessor corporations are exchanged for or become shares of the new corporation. The amendment to subsection 87(8) and the addition of subsection 87(8.1) apply to foreign mergers occurring after November 12, 1981.

Subclauses 52(9) to (15)

These set out the effective dates for the amendments to section 87 of the Act.

Winding-up of a Corporation

Clause 53

Subclause 53(1)

ITA 88(1)(d)

Subsection 88(1) of the Act sets out detailed rules relating to the winding-up of a subsidiary into a parent corporation that owns at least 90% of its shares. On wind-up, paragraphs 88(1)(c) and (d) permit the parent to increase the cost base of certain non-depreciable capital assets owned by the subsidiary in circumstances where the adjusted cost base of the parent's shares in the subsidiary exceeds the net value of the subsidiary's assets determined on a tax basis. This increase in the cost base is generally referred to as the "section 88 bump".

Paragraph 88(1)(d) is amended to exclude from the section 88 bump any assets acquired by the subsidiary as a result of a transfer to it of property in the course of a reorganization, generally referred to as a "butterfly", as described in paragraph 55(3)(b) of the Act. This amendment applies to winding-up distributions occurring after June 28, 1982.

Subclause 53(2)

ITA 88(1)(d)(i.1)(B)

Subparagraph 88(1)(d)(i.1) of the Act applies to reduce the amount eligible for the section 88 bump by the amount of taxable dividends and capital dividends received by the parent and by related corporations on the subsidiary's shares before the time of winding-up. Effective after June 28, 1982, the amendment to clause 88(1)(d)(i.1)(B) extends this rule to include life insurance capital dividends. The treatment of life insurance capital dividends is discussed in the commentary on paragraph 89(1)(b.2) of the Act.

Subclause 53(3)

ITA 88(1)(d.1)

Paragraph 88(1)(d.1) provides that certain other rules in the Act and in the Income Tax Application Rules, 1971 relating to a winding-up do not apply to a winding-up governed by subsection 88(1) of the Act. This paragraph is amended to include a reference to the new subsection 85(5.1) of the Act relating to transfers of depreciable property. This ensures that the new rules provided in that subsection will not apply with respect to a transfer of property in the course of a winding-up to which the provisions of subsection 88(1) apply.

ITA 88(1)(d.2)

The "section 88 bump" in the cost base of certain non-depreciable capital assets under paragraphs 88(1)(c) and (d) of the Act is available only with respect to capital assets that were owned by a subsidiary corporation when its parent last acquired control. Paragraph 88(1)(d.2) provides rules for determining when control has been acquired in certain non-arm's length transactions. This paragraph is amended so that, when any share of the subsidiary is transferred in a non-arm's length transaction, control of the subsidiary is deemed to have been acquired at the time the vendor last acquired control of the subsidiary.

These amendments apply to windings-up commencing after November 12, 1981.

Subclauses 53(4) and (5)

ITA
88(1)(e.2)
88(1)(e.2)(xiv), (xv) and (xvi)

Under paragraph 88(1)(e.2) of the Act, many of the detailed rules to be applied on the winding-up of a subsidiary into its parent are established by reference to the specific provisions in section 87 relating to amalgamations. The amendments to paragraph 88(1)(e.2) make reference to new paragraphs 87(2)(y.1), (z.1), (ll) and (mm), and are strictly consequential on the introduction of these provisions in the Act.

Subclause 53(6)

ITA
88(1)(e.3)

Paragraph 88(1)(e.3) of the Act requires the cumulative deduction account of the subsidiary to be added to the cumulative deduction account of the parent on a subsection 88(1) winding-up. Paragraph 88(1)(e.3) is amended to facilitate the tracking of the subsidiary's cumulative deduction account in those circumstances where there is a transaction to which the rules in subsections 125(8.1) through (8.6) of the Act apply. This amendment applies to taxation years ending after 1982.

Subclause 53(7)

ITA
88(1)(e.6)

Paragraph 88(1)(e.6) of the Act permits the undeducted portion of the subsidiary's charitable donations, gifts to Her Majesty and gifts to certain cultural institutions to be available as a deduction to the parent. This paragraph is amended as a result of the amendments to paragraphs 110(1)(a), (b) and (b.1) of the Act permitting a five-year carry-forward for the undeducted portion of such gifts. This amendment applies to gifts made in the 1981 and subsequent taxation years.

Subclause 53(8)

ITA
88(1.1)

Subsection 88(1.1) of the Act permits a parent corporation to utilize a subsidiary's non-capital losses where a subsidiary that is at least 90% owned by its parent has been wound up. The amendments to subsection 88(1.1) are necessary because of the amendments to subsection 111(5) of the Act relating to the utilization of non-capital losses where control of a corporation has changed.

The effect of the amendments to subsection 88(1.1) is to restrict the deduction by the parent of any unused non-capital losses of the subsidiary where there has been a change of control. A non-capital loss incurred by a subsidiary from carrying on a particular business can only be deducted by the parent within certain limitations, where control of the parent or subsidiary changes. To qualify for deduction, the particular business must have been carried on since the change in control for profit or with a reasonable expectation of profit. In addition, the non-capital loss can be deducted by the parent only against income from the particular business, any other substantially similar business and net taxable capital gains from certain property owned by the subsidiary.

Subject to a transitional provision for certain changes of control that were substantially advanced on November 12, 1981, these amendments generally apply with respect to windings-up commencing after November 12, 1981.

Subclause 53(9)

ITA
88(1.3)

Subsection 88(1.3) of the Act deems a parent corporation to have been in existence throughout the period in which its subsidiary was in existence to ensure that the parent can effectively carry forward the non-capital losses and net capital losses of a subsidiary that were not deducted before it was wound up. The amendments to this subsection extend the same rule to unclaimed charitable contributions of a subsidiary and are consequential on the amendments to subsection 110(1) relating to the five-year carry-forward for the undeducted portion of charitable donations, gifts to Her Majesty and gifts to certain cultural institutions. This amendment applies to gifts made in the 1981 and subsequent taxation years.

Subclause 53(10)

ITA
88(2)(b)

Subsection 88(2) of the Act applies to a winding-up that is not governed by subsection 88(1) and provides special rules for determining the breakdown of any distribution on a winding-up as between a capital dividend, a taxable dividend or other special category of distribution. Paragraph 88(2)(b) is amended to deal with a life insurance capital dividend. The amendment is consequential on the addition of subsection 83(2.1) and paragraph 89(1)(b.2) which introduce rules for the distribution of life insurance capital dividends. This amendment applies to windings-up ending after June 28, 1982.

Subclause 53(11)

ITA
88(3)

Subsection 88(3) of the Act permits a Canadian resident taxpayer to receive shares of a foreign affiliate in the course of the dissolution of another foreign affiliate on a tax-deferred "rollover" basis. Effective for liquidations commencing after November 12, 1981 (other than a liquidation that was part of a reorganization that was substantially advanced before November 13, 1981), subsection 88(3) is amended to apply where the dissolved foreign affiliate is a controlled foreign affiliate of the taxpayer.

Subclauses 53(12) to (21)

These set out the effective dates for the amendments to section 88 of the Act.

Clause 54

Subclause 54(1)

ITA
89(1)(b)(i)

Paragraph 89(1)(b) of the Act defines the "capital dividend account" of a private corporation. Where an appropriate election has been made, dividends paid out of the capital dividend account are received tax-free by the corporation's shareholders. One of the components of the capital dividend account is the untaxed half of capital gains net of capital losses realized by the corporation.

Subparagraph 89(1)(b)(i) is amended to exclude from the capital dividend account the portion of realized capital gains or losses on property which accrued during any period that the property was held by a corporation that was not a private corporation. This amendment applies to dispositions occurring after November 12, 1981, but does not apply to a disposition of designated property as defined in the new paragraph 89(1)(b.1) of the Act.

Subclause 54(2)

ITA
89(1)(b)(iv)

Subparagraph 89(1)(b)(iv) of the Act includes in the capital dividend account of a private corporation certain life insurance proceeds it received on the death of a person to the extent that they exceed the corporation's adjusted cost basis of the policy. The amendment to subparagraph 89(1)(b)(iv) continues this treatment where the corporation was a beneficiary under the policy on or before June 28, 1982. Where the corporation became the beneficiary under a policy after June 28, 1982, the life insurance proceeds are included in the life insurance capital dividend account under the new paragraph 89(1)(b.2) of the Act.

Subclause 54(3)

ITA
89(1)(b.1)

New paragraph 89(1)(b.1) of the Act defines "designated property" for purposes of the capital dividend account of a corporation. Designated property is defined as property acquired before November 13, 1981 (or after November 12, 1981 pursuant to an agreement in writing entered into on or before that date) by a corporation that last became a private corporation on or before November 12, 1981. Notwithstanding the basic changes to subparagraph 89(1)(b)(i) of the Act, gains and losses on designated property will continue to be included in the capital dividend account.

ITA
89(1)(b.2)

Very often the shares of a private corporation acquired by an estate, heir or beneficiary as a consequence of the death of a shareholder are redeemed by the corporation. If the corporation has a capital dividend account—for example, from life insurance proceeds received on the death of the shareholder—the portion of the share proceeds arising under subsection 84(3) on the redemption out of that account would be tax-free as a capital dividend. Since the adjusted cost base of the shares is not reduced by any capital dividend, a capital loss would very often result on the redemption of the shares. In these circumstances, the capital loss could either be used by the estate to recover tax paid in the deceased's final taxation year on the deemed disposition of his shares arising on his death, or the loss could be used to reduce other capital gains of the beneficiaries.

Where a private corporation has become the beneficiary under a life insurance policy after June 28, 1982, the gain on a life insurance policy will no longer be included in its capital dividend account. However, to recognize the fact that a portion of life insurance proceeds should be transferred tax-free to the shareholders, paragraph 89(1)(b.2) has been added to the Act to establish a life insurance capital dividend account. Life insurance proceeds received by a corporation on the death of a person will be added to this new account to the extent that they exceed the adjusted cost basis of the policy. This treatment will apply to life insurance policies of which the corporation became a beneficiary after June 28, 1982 when the new rule was announced. Tax-free dividends can be paid from the life insurance capital dividend account provided an election has been made under new subsection 83(2.1). Under paragraph 53(2)(r), such tax-free life insurance capital dividends will reduce the adjusted cost base of the shares on which they are paid where the shares, or shares for which they were substituted, were acquired by an estate, heirs or beneficiaries as a consequence of the death of the shareholder.

Subclause 54(4)

ITA
89(1)(j)

Paragraph 89(1)(j) defines the expression "taxable dividend". The purpose of the amendment to subparagraph 89(1)(j)(i) is to add a reference to life insurance capital dividends so that they are not included as taxable dividends. This amendment applies to dividends paid after June 28, 1982.

Subclause 54(5)

ITA
89(1.1)

Under subsection 89(1.1) of the Act, where a private corporation controlled by non-residents becomes a Canadian-controlled private corporation, its capital dividend account immediately before this change in status is eliminated. The amendment to subsection 89(1.1) extends the same treatment to the life insurance capital dividend account on the change in status of the corporation.

ITA
89(2) and (2.1)

Subsections 89(2) and (2.1) are new provisions added to the Act relating to the capital dividend and life insurance capital dividend accounts of a corporation. A corporate beneficiary under a life insurance policy on June 28, 1982 will not be considered to be a beneficiary on that date if a change is made to the terms and conditions of the policy after December 1, 1982, or if a premium which was not fixed on or before December 1, 1982 is paid under the policy after that date. In these circumstances, the policy will be treated as a new policy and, therefore, any proceeds realized on it will be included in the new life insurance capital dividend account of the corporation rather than in its ordinary capital dividend account. The treatment as a new policy will not apply, however, by virtue only of the fact that after December 1, 1982 the policy is assigned to secure a debt or loan or the policy lapses as a result of unpaid premiums and is reinstated within 60 days of the end of the calendar year in which the lapse occurred. In addition, the proceeds of a life insurance policy of which a corporation is a beneficiary on or before June 28, 1982 will continue to be included in the capital dividend account if another corporation becomes the beneficiary by virtue of a subsequent amalgamation under subsection 87(1) or a winding-up under subsection 88(1) of the Act.

Subclauses 54(6) to (10)

These set out the effective dates for the amendments to section 89 of the Act.

Disposition of Shares of a Foreign Affiliate

ITA
93(1.1)

Clause 55

Subsection 93(1) of the Act permits a resident corporation to elect to treat proceeds received on a sale of shares of a foreign affiliate as a dividend rather than as proceeds of disposition. This election allows the corporation to obtain the benefit of any exempt or taxable surplus that relates to the share of the foreign affiliate which has been disposed of without the affiliate actually declaring a dividend.

Subsection 93(1.1) is added to the Act to provide that the rule described above will automatically apply, without the need for an election, where a foreign affiliate of a resident corporation disposes of shares of a second foreign affiliate that qualify as "excluded property" as defined in paragraph 95(1)(a.1) of the Act. The amount of the proceeds subject to this automatic rule will be determined by Regulation as the pro rata portion of the second affiliate's net surplus, but will not in any event exceed the capital gain otherwise determined on the disposal. Subsection 93(1.1) applies to dispositions occurring after November 12, 1981.

Foreign Affiliate Trusts

Clause 56

ITA 94(1)(a) and (b)

Under section 94 of the Act, the income of a non-resident trust is subject to Canadian taxation in the circumstances specified in paragraphs 94(1)(a) and (b) of the Act. The amendments to these paragraphs extend the application of section 94 in certain circumstances where an interest in a non-resident trust has been acquired by a beneficiary by way of purchase or by way of a gift, bequest or inheritance from, or exercise of a power of appointment by, certain persons.

ITA 94(7)

Subsection 94(7) is added to the Act to describe the circumstances in which a person will be regarded as beneficially interested in a trust for purposes of the rules in section 94. This will apply where a person has a right, whether immediate or future, absolute, contingent or conditional, to the income or capital of a trust either directly or indirectly through one or more other trusts.

These amendments are applicable after November 12, 1981.

Foreign Affiliate Definitions

Clause 57

Subclauses 57(1), (2) and (3)

ITA
95(1)(a.1)

The foreign accrual property income of a controlled foreign affiliate is added to the income of the Canadian resident shareholder in the year in which it is earned by the affiliate rather than the year in which it is distributed. Foreign accrual property income ("FAPI") includes taxable capital gains realized by the affiliate other than gains from the disposition of property used principally to produce income from an active business. Paragraph 95(1)(a.1) adds a new definition of "excluded property" to expand the categories of property which will not give rise to foreign accrual property income when the property is sold.

Excluded property of a foreign affiliate means property used by the affiliate principally in an active business, shares of another foreign affiliate where substantially all of its property is excluded property and certain amounts receivable. For the purposes of this definition, the business assets of a partnership will qualify as excluded property in those circumstances where a foreign affiliate has at least a 10% interest in the partnership. The 10% interest itself will qualify as excluded property if substantially all of the partnership assets are excluded property.

ITA
95(1)(b)(ii) and (iv)

Paragraph 95(1)(b) of the Act defines foreign accrual property income. Subparagraphs 95(1)(b)(ii) and (iv) are amended so that taxable capital gains and allowable capital losses from dispositions of excluded property are excluded from foreign accrual property income. These amendments apply to dispositions occurring after November 12, 1981.

Subclause 57(4)

ITA
95(1)(c)

Paragraph 95(1)(c) of the Act defines the expression "foreign accrual tax". This represents foreign tax paid by a foreign affiliate that is applicable to its foreign accrual property income. A deduction is provided under subsection 91(4) in respect of foreign accrual tax where the foreign accrual property income to which the tax relates has been included in the income of a Canadian resident shareholder.

The definition of foreign accrual tax is amended to add any amount prescribed by Regulation as foreign accrual tax. The Regulations will be amended to accommodate the difficulties that arise when laws in a foreign country permit consolidated reporting for tax purposes or otherwise allow the transfer of losses within a corporate group. This amendment applies for the 1982 and subsequent taxation years.

Subclause 57(5)

ITA 95(1)(f.1)

New paragraph 95(1)(f.1) adds to the Act a definition of "surplus entitlement percentage" of a taxpayer and authorizes Regulations to determine its meaning. The expression "surplus entitlement percentage" in a number of provisions of the Act and the Income Tax Regulations is a measure of the ownership percentage in a foreign affiliate. It is used, for example, in new paragraphs 95(2)(d.1) and (e.1) of the Act relating to mergers and liquidations of foreign affiliates.

In general terms, the surplus entitlement percentage of a taxpayer resident in Canada in respect of a foreign affiliate is the percentage of the net surplus of the affiliate that the taxpayer would receive if the affiliate and each other foreign affiliate in which the foreign affiliate has an equity percentage were to pay out its net surplus as a dividend. In situations where all the relevant affiliates have only one class of shares, the surplus entitlement percentage will equal the equity percentage.

Subclause 57(6)

ITA 95(2)(b)(i)

Under paragraph 95(2)(b) of the Act, amounts paid to a controlled foreign affiliate of a taxpayer for services are added to that affiliate's foreign accrual property income if the amount is deductible by the taxpayer in computing his income from a business carried on in Canada. Subparagraph 95(2)(b)(i) is amended to prevent a Canadian resident from attempting to avoid this provision by arranging for the payments to an affiliate for services to be made through a third party. This is achieved by extending subparagraph 95(2)(b)(i) to include a payment made by a third party to a controlled foreign affiliate of a taxpayer for services to the extent that such payment may reasonably be considered to relate to an amount deductible from income earned from a business carried on in Canada by the taxpayer or a person related to the taxpayer. This amendment applies to amounts paid or payable after November 12, 1981.

Subclause 57(7)

ITA 95(2)(d)

Paragraph 95(2)(d) provides that, in determining foreign accrual property income, no gain or loss is recognized with respect to the disposition of shares of a foreign affiliate on its merger with another corporation to form a new foreign affiliate. Paragraph 95(2)(d) is amended as a consequence of the introduction of the definition of "foreign merger" in subsection 87(8.1) of the Act, to permit a tax-free "rollover" of shares of a non-resident corporation owned by a foreign affiliate on the merger after November 12, 1981 of the corporation with another non-resident corporation.

ITA 95(2)(d.1)

Paragraph 95(2)(d.1) is a new provision which provides that, in determining foreign accrual property income, no gain or loss will be recognized on a disposition of capital property of a foreign affiliate as a consequence of a foreign merger if a Canadian resident had at least a 90% surplus entitlement percentage both in the predecessor foreign corporations and in the new corporation formed on the merger. Previously, rollover treatment was available only with respect to shares of a foreign affiliate disposed of on a merger. This amendment applies to foreign mergers occurring after November 12, 1981.

Subclauses 57(8) and (9)

ITA
95(2)(e) and (e.1)

Paragraph 95(2)(e) of the Act provides rules for determining foreign accrual property income when a foreign affiliate of a taxpayer dissolves and distributes shares of another foreign affiliate to a shareholder that is also a foreign affiliate. Paragraph 95(2)(e) is amended to provide that new paragraph 95(2)(e.1) overrides paragraph 95(2)(e) where both paragraphs would otherwise apply.

New paragraph 95(2)(e.1) relates to liquidations of foreign affiliates. The paragraph applies only where the taxpayer has at least a 90% surplus entitlement percentage in the affiliate being wound up and where the capital property distributed on the liquidation to another foreign affiliate does not give rise to a gain or loss for tax purposes in the foreign country in which the affiliates reside. In these circumstances, no capital gain or loss is recognized for the purposes of the foreign accrual property income rules on any capital property distributed on the liquidation to another foreign affiliate nor will any gain or loss be recognized by the parent foreign affiliate on the disposition of the shares of the foreign affiliate being wound up.

These amendments apply with respect to dissolutions occurring or liquidations commencing after November 12, 1981.

Subclause 57(10)

ITA
95(2)(f)

Paragraph 95(2)(f) of the existing Act provides that taxable capital gains and allowable capital losses are calculated, for the purpose of determining foreign accrual property income, as if the foreign affiliate were resident in Canada. This paragraph is amended to clarify the currency in which capital gains and losses of foreign affiliates are to be calculated. In the case of the disposition of property, other than excluded property, of a controlled foreign affiliate, the gain or loss is calculated in Canadian currency. In any other case, the currency of the country in which the foreign affiliate resides, or such other currency as is appropriate, is used to calculate gains or losses. These rules apply after November 12, 1981.

Subclause 57(11)

ITA
95(2)(g)

Paragraph 95(2)(g) of the existing Act provides that foreign currency gains or losses realized on the settlement of debts owing between foreign affiliates or between a foreign affiliate and a non-arm's length non-resident corporation are ignored for the purpose of determining foreign accrual property income. This paragraph is amended to provide that this rule will apply after November 12, 1981 for the purposes of all the foreign affiliate provisions of the Act and Regulations.

Subclause 57(12)

ITA 95(2)(h)

In general, foreign currency gains or losses of a foreign affiliate must be taken into account in determining foreign accrual property income of a foreign affiliate. However, paragraph 95(2)(h) of the Act allows such gains or losses to be ignored where the gain or loss is realized by a foreign affiliate on the redemption, cancellation or acquisition of shares of, or on the reduction of capital of, another affiliate of the taxpayer or on a non-arm's length disposal of shares of another affiliate. Paragraph 95(2)(h) is amended to provide that this rule will apply after November 12, 1981 for the purposes of all the foreign affiliate provisions of the Act and Regulations.

Subclause 57(13)

ITA 95(2)(i)

Paragraph 95(2)(i) of the Act is a new provision which treats a foreign currency gain or loss arising from the repayment after November 12, 1981 of a debt incurred to acquire excluded property as a gain or loss from the disposition of excluded property. The effect of this provision is to exclude such gains or losses from foreign accrual property income.

ITA 95(2)(j)

Paragraph 95(2)(j) of the Act is a new provision to authorize rules to be provided in the Regulations for determining the adjusted cost base to a foreign affiliate of a partnership interest. In general terms, the new Regulations will provide that the cost of the partnership interest will be increased by earnings, contributions of capital and tax refunds, and reduced by losses, withdrawals of capital or profits, and taxes paid. These rules apply on dispositions of partnership interests after November 12, 1981.

Subclauses 57(14) to (21)

These set out the effective dates for the amendments to section 95 of the Act.

Transfers of Property to a Partnership

Clause 58

ITA 97(2)

Subsection 97(2) of the existing Act allows any property to be transferred by a partner to a Canadian partnership on a tax-deferred "rollover" basis. This subsection is amended to limit the types of property that can be transferred under subsection 97(2) to capital property, certain resource properties, eligible capital property and inventory. It is also revised to incorporate, with appropriate changes, the rules in subsection 85(1) of the Act relating to transfers of property to a corporation. These rules determine the transferor's proceeds of disposition, the partnership's cost of the property and the cost to the transferor of property received as consideration for the transfer. The rules in subsection 97(2) relating to adjustments to the cost base of the partner's interest in the partnership are generally unchanged but a rule is added deeming the partnership interest to constitute taxable Canadian property where the transferred property was itself taxable Canadian property. "Taxable Canadian property" is a technical expression defined in subsection 115(1) and generally means capital property any gain on which would be taxable under the Act if it were disposed of by a non-resident.

The provisions of new subsection 85(5.1) of the Act may override the rollover provisions of subsection 97(2). This will apply only where the fair market value of depreciable property is less than both its cost and its undepreciated capital cost at the time of transfer.

ITA 97(3)

Subsection 97(3) of the existing Act denies a deduction for any loss realized by a majority interest partner on the transfer of property to a partnership. Any loss so disallowed is added to the cost of the transferor's partnership interest. This subsection is amended to restrict its application to capital losses sustained on transfers of property.

ITA 97(3.1)

Subsection 97(3.1) is a new provision introduced to the Act to provide a definition of the term "majority interest partner" for the purpose of the rule in subsection 97(3) described above. A taxpayer will be considered to be a majority interest partner if the taxpayer, his spouse and certain related parties are entitled to more than 50% of the partnership income for the year. A taxpayer will also fall within the definition where the taxpayer, his spouse and certain related parties would be entitled to more than 50% of the partnership property if the partnership were to be wound up. These rules differ from those that they replace in existing subsection 97(3) for determining a majority interest in a partnership by looking, not only to the interest of the taxpayer himself, but also to the interest in the partnership of his spouse and certain other persons related to him.

The amendments to section 97 of the Act apply to dispositions occurring after November 12, 1981, other than dispositions occurring before 1983 if the arrangements therefor were substantially advanced and evidenced in writing on November 12, 1981.

Disposition of a Partnership Interest

ITA 100(4)

Clause 59

Section 100 of the Act provides rules for computing a taxpayer's taxable capital gain or allowable capital loss on the disposition of an interest in a partnership. Subsection 100(4) is a new provision which reduces the capital loss of a corporate partner arising on the disposition of a partnership interest in certain circumstances. The capital loss is reduced where the partnership owns shares of a corporation and the partner's share of a partnership loss would have been reduced by virtue of the new rules provided in subsection 112(3.1) or (4.2) of the Act if the partnership had disposed of its shares at fair market value immediately before the corporate partner disposed of its partnership interest. Subsections 112(3.1) and (4.2) extend the so-called "stop-loss" rules in section 112 and reduce, in specified circumstances, a corporate partner's share of a partnership loss on a sale of shares. This amendment is applicable to dispositions occurring after November 12, 1981.

Clause 60

Subclause 60(1)

ITA
104(4)

Subsection 104(4) of the Act deems all non-depreciable capital property of a trust to have been disposed of for its fair market value at certain times. Generally, those times are on the death of a spouse and every 21 years thereafter, in the case of a spousal trust, and every 21 years, in the case of other trusts. The amendment to subsection 104(4) expands the properties of a trust to which the deemed disposition rules apply after November 12, 1981 to include resource properties and land inventories of a trust.

Subclause 60(2)

ITA
104(6)(a.1) and (b)

Subsection 104(6) of the Act permits a trust to deduct in a year any income payable in the year to a beneficiary. Paragraph 104(6)(a.1) is added to provide that an employee benefit trust established by an employer may only deduct income paid in the year to a beneficiary. This matches the timing of the trust deduction with the employee inclusion—only when amounts are actually paid out of an employee benefit trust are they included in an employee's income.

Paragraph 104(6)(b) of the Act is amended so that a spousal trust cannot deduct taxable capital gains or other income payable to a beneficiary where the income arose as a consequence of a disposition of property under subsection 104(4) or (5) of the Act. The amendment also denies a deduction, from the amount included in the income of a spousal trust, arising from the deemed disposition under subsection 107(4) on a distribution of trust property to a person other than the spouse. The amendments to paragraph 104(6)(b) thus require such income to be taxed as income of the spousal trust rather than as income of the beneficiaries.

The amendment adding paragraph 104(6)(a.1) applies to the 1981 and subsequent taxation years, and the amendment to paragraph 104(6)(b) applies with respect to dispositions of property after November 12, 1981.

Subclause 60(3)

ITA
104(8)

Subsection 104(8) of the Act prohibits an *inter vivos* trust from deducting any designated income payable in a year to a designated beneficiary. For this purpose, "designated beneficiary" means a non-resident person, a non-resident-owned investment corporation or a trust that has non-resident beneficiaries. "Designated income" is defined in paragraph 108(1)(d.1) and generally means income on which a non-resident would be taxable under Part I of the Act if he earned the income directly. The result is that designated income payable to a non-resident beneficiary is taxed in the hands of the trust and is not taxed when distributed to the beneficiary.

Subsection 104(8) of the Act is amended in three respects. First, it now applies to testamentary trusts as well as *inter vivos* trusts. Second, it does not apply where the designated beneficiary is a trust resident in Canada that is exempt under subsection 149(1) of the Act. This would include, for example, a trust under a registered pension plan. Third, subsection 104(8) now also applies where a spousal trust has taxable capital gains or other income in a taxation year which arose from a deemed disposition after November 12, 1981 under subsections 104(4) or (5) or 107(4) of the Act and the trust has made a preferred beneficiary election for the year. In these circumstances, the rules in subsection 104(8), as amended, provide ordering rules to determine the amount of the trust income which is deductible as income payable to beneficiaries and the amount of the accumulating income of the trust which is eligible for the preferred beneficiary election.

These amendments apply after November 12, 1981 except for the amendment which extends subsection 104(8) to a testamentary trust. That amendment applies for taxation years commencing after November 12, 1981.

Subclause 60(4)

ITA
104(13)

Subsection 104(13) of the existing Act applies to trusts other than a trust under an employee benefit plan. It requires the trust income that is payable to a beneficiary and deductible to the trust under subsection 104(6) to be included in the beneficiary's income whether or not it is actually paid in the year. The amendment to subsection 104(13) allows a deduction to an employee benefit plan trust only for income actually paid by the trust in the year.

This amendment applies to the 1980 and subsequent taxation years. It provides a means for relieving the double taxation that can result when the income of an employee benefit plan is not fully distributed in a year to employees. By providing for such income to be paid out to an employer and paid back by it as an additional contribution, the employer will include such income in the computation of income under paragraphs 104(13)(a) and 12(1)(m) of the Act and will be entitled to a deduction for the additional contribution in accordance with section 32.1 of the Act.

Subclause 60(5)

ITA
104(17.1)

Under subsections 104(16) and (17) of the Act, a trust is entitled to allocate its capital cost allowance and earned depletion to income beneficiaries of the trust in lieu of claiming such deductions within the trust itself. Subsection 104(17.1) is added to the Act to require capital cost allowance and depletion to be allocated to beneficiaries on a basis proportionate to their share of the income of the trust. This is intended to prevent a trust with both taxable and non-taxable beneficiaries from "streaming" these deductions only to its taxable beneficiaries. This amendment applies to taxation years commencing after November 12, 1981.

Subclause 60(6)

ITA 104(19)

Subsection 104(19) of the Act provides that taxable dividends on shares of a taxable Canadian corporation that are flowed through a trust retain their character as taxable dividends in the hands of beneficiaries of the trust for the purposes of section 82 of the Act. Such dividends are therefore eligible for the dividend tax credit where the beneficiary is an individual. The amendment to subsection 104(19) provides that such dividends will retain their character in the hands of beneficiaries for all purposes of the Act other than for the purpose of the non-resident withholding tax under Part XIII. Taxable dividends flowing through a trust to a non-resident beneficiary will continue to be treated as income from a trust rather than as dividend income for non-resident withholding tax purposes. This amendment applies to designations made after November 12, 1981 by the trust in respect of taxable dividends allocated to a beneficiary.

Subclauses 60(7) to (9)

ITA 104(22)

Subsection 104(22) of the Act provides the rules for allocating the foreign source income and foreign taxes of a trust as between the trust and its beneficiaries for purposes of the foreign tax credit under section 126 of the Act. The introductory wording of subsection 104(22) is amended to provide that these rules apply for the purposes of the subsection itself as well as section 126. The effect of this amendment is to permit the foreign source income and foreign taxes of a trust to retain their identity in those circumstances where one trust is a beneficiary of another trust.

ITA 104(22)(b)

Paragraph 104(22)(b) provides for the allocation to specific beneficiaries of foreign tax paid by a trust. This paragraph is amended to exclude from the allocation foreign tax which the trust has deducted under subsection 20(12) in computing its income. That subsection permits certain foreign taxes to be deducted in computing income as an alternative to claiming a foreign tax credit. The amendment to paragraph 104(22)(b) thus prevents a beneficiary from claiming a credit for foreign taxes that have also been claimed as a deduction by a trust.

ITA 104(22)(d)

Paragraph 104(22)(d) determines the amount of foreign tax paid by the trust that is eligible for deduction by the trust as a foreign tax credit after taking into account the foreign tax allocated to beneficiaries. This paragraph is amended to exclude foreign taxes which the trust has deducted from its income under subsection 20(12) of the Act.

These amendments to subsection 104(22) apply for taxation years ending after November 12, 1981.

Subclause 60(10)

ITA 104(25) and (25.1)

Subsection 104(13) of the Act requires the income of a trust payable to a beneficiary to be included in the income of the beneficiary. Subsection

104(6) of the Act permits the trust to deduct such income. However, subsection 104(8) prohibits the deduction by the trust of certain designated income payable to a beneficiary, with the result that such income is taxed in the hands of the trust. Subsection 104(25) prevents such income from also being taxed in the hands of the beneficiary. It does this by allowing the trust to designate such income, in which event it will be considered as if it were not payable to the beneficiary.

The amendment to subsection 104(25) and the addition of subsection 104(25.1) are consequential on the amendments to subsections 104(6) and (8) which introduced additional circumstances in which trust income payable to a beneficiary cannot be deducted by the trust. These amendments apply after November 12, 1981.

Subclause 60(11)

ITA 104(27)

Subsection 104(27) of the Act is a new provision which allows a superannuation or pension benefit received by a testamentary trust to retain its character when flowed through the trust to a beneficiary. To the extent that such benefits can reasonably be considered to have been payable to a beneficiary, they will be treated as a superannuation or pension benefit for purposes of paragraph 60(j) of the Act and, in the case of the spouse of the deceased testator, for purposes of section 110.2. As a result, the beneficiary will be eligible to transfer the superannuation or pension benefit into a registered pension plan or registered retirement savings plan. In addition, the benefit will qualify in the hands of the spouse for the $1,000 pension income exemption under section 110.2.

ITA 104(28)

Subsection 104(28) of the Act is a new provision which permits an amount received by a testamentary trust upon or after the death of an employee and in recognition of his services to retain its character when flowed through the trust to a beneficiary. Under this subsection, such an amount will be deemed to have been received by the beneficiary after the death of the employee in recognition of his services and not to have been received by the trust. Under the definition of a "death benefit" in subsection 248(1) of the Act, up to $10,000 of such amount received by the spouse of the deceased (or children where the spouse is deceased) may be excluded from income. Any remainder will be included in the income of the recipient under subsection 56(1) of the Act.

Subsections 104(27) and (28) apply for taxation years ending after November 12, 1981.

Subclauses 60(12) to (17)

These set out the effective dates for the amendments to section 104 of the Act.

Income Interests in Trusts

Clause 61

ITA 106(1.1)

Subsection 106(1) of the existing Act permits an income beneficiary of a trust to deduct the cost of his interest in the trust in computing his income from the trust. Subsection 106(1.1) is added to the Act, effective after November 12, 1981, to deem the cost to a taxpayer of an income interest in a trust to be nil except where it is acquired from a previous beneficiary.

Capital Interests in Trusts

Clause 62

Subclause 62(1)

ITA 107(1)(c)

Subsection 107(1) of the Act provides rules for determining the taxable capital gain or allowable capital loss from the disposition of a capital interest in a trust. Paragraph (c) is added to subsection 107(1) so that the capital loss of a corporate beneficiary arising on its disposition of a capital interest in a trust is reduced by the amount of dividends previously flowed through the trust to the corporation. This amendment, which complements similar amendments to the "stop-loss" rules in section 112 of the Act, applies to any disposition of a capital interest in a trust after November 12, 1981.

Subclause 62(2)

ITA 107(1.1)

Subsection 107(1.1) of the existing Act provides special rules for determining the cost of a capital interest in a testamentary trust. This subsection is amended to apply to capital interests in all trusts. It provides that, effective after November 12, 1981, the cost of a capital interest in any trust is deemed to be nil except where it is acquired from a previous beneficiary or where it is issued to the taxpayer for full consideration.

Subclause 62(3)

ITA 107(4)(a)

Subsection 107(4) of the Act applies where a spousal trust distributes capital property during the spouse's lifetime to a beneficiary other than the spouse. It provides that non-depreciable capital property so distributed is deemed to have been disposed of at its fair market value, and that depreciable property is deemed to have been disposed of for proceeds equal to the mid-point between its undepreciated capital cost and fair market value. Paragraph 107(4)(a) is amended, effective after November 12, 1981, to include resource properties and land inventory of the trust in the categories of property that will be deemed to have been disposed of at fair market value when distributed by a spousal trust to a beneficiary other than the spouse.

Subclauses 62(4) and (5)

These set out the effective date for the amendments to section 107 of the Act.

Definitions Relating to Trusts

Clause 63

Subclause 63(1)

ITA
108(1)(a)

Paragraph 108(1)(a) of the Act defines the term "accumulating income" of a trust as its income before making any deduction as a result of a preferred beneficiary election. A preferred beneficiary election enables income of a trust which is not payable to a beneficiary to nonetheless be included in a preferred beneficiary's income and deducted by the trust. This amendment will exclude from accumulating income any taxable capital gains or other income of a spousal trust which arose from a deemed disposition of property under subsection 104(4) or (5) or under subsection 107(4) as a result of the distribution of trust property to a person other than the spouse. This amendment ensures that after November 12, 1981 such income is taxed in the trust and is not eligible for the preferred beneficiary election.

Subclause 63(2)

ITA
108(1)(i)

Paragraph 108(1)(i) of the existing Act defines a "testamentary trust" as a trust that arose upon and in consequence of the death of an individual and was created by the deceased individual. Any trust which is not a testamentary trust is an *inter vivos* trust for purposes of the Act. Certain *inter vivos* trusts are subject to a minimum rate of tax of 34% under the Act whereas testamentary trusts are taxable at the progressive rates of tax applicable to individuals.

Paragraph 108(1)(i) is amended to remove from the definition of a testamentary trust certain trusts to which property has been contributed otherwise than by an individual as a consequence of his death. Any trust created after November 12, 1981 is excluded from the definition where any property has been contributed to it otherwise than by an individual on his death. Any trust created before November 13, 1981 is also denied treatment as a testamentary trust where property has been contributed to the trust after June 28, 1982 otherwise than by an individual on his death, or where more than 50% of the fair market value of the property owned by the trust has been contributed otherwise than by an individual on his death. Such trusts will, therefore, be treated as *inter vivos* trusts for purposes of the Act. This amendment applies to taxation years commencing after November 12, 1981.

Subclause 63(3)

ITA
108(5)

Subsection 108(5) of the Act is a new provision which provides that the nature of income or deductions flowing through a trust to a beneficiary of the trust is retained only where the Act specifically so provides. This rule does not affect the so-called "attribution rules" in sections 74 and 75 of the Act under which the income and capital gains of property transferred by a taxpayer to his spouse or to a minor is taxable in the hands of the taxpayer.

As a result of new subsection 108(5), the only categories of income that retain their character when flowed through a trust to a beneficiary are dividends, taxable capital gains, foreign source income, eligible interest from Canadian sources, superannuation or pension benefits and amounts received upon or after the death of an employee in recognition of services. The only deductions that retain their character when flowed through a trust to a beneficiary are capital cost allowance and earned depletion. Subsection 108(5) applies for taxation years commencing after November 12, 1981.

Subclauses 62(4) to (8)

These set out the effective date for the amendments to section 108 of the Act.

Personal Exemptions

Clause 64

ITA
109(1)(b) and (f)

Section 109 of the Act provides the personal exemptions that are deductible in computing an individual's taxable income. The deduction under paragraph 109(1)(b) is commonly referred to as the married equivalent deduction for taxpayers who are unmarried, separated or divorced and support a dependant in their ordinary place of residence. The deduction under paragraph 109(1)(f) is for dependent parents, grandparents, brothers and sisters. The amendments to paragraphs 109(1)(b) and (f) require that, to qualify for deduction in a year, a dependant (other than the taxpayer's spouse, children or grandchildren) must have been resident in Canada at some time during the year. These amendments apply to the 1982 and subsequent taxation years.

Clause 65

Section 110 of the Act provides for a number of deductions in computing taxable income, including those for charitable donations and medical expenses.

Subclauses 65(1) and (2)

ITA
110(1)(a), (b)
and (b.1)

Under paragraphs 110(1)(a), (b) and (b.1) of the existing Act, charitable donations, including gifts to the federal or a provincial government and certain gifts of cultural property, are deductible in computing taxable income only in the year in which the gift was made or in the following year. The maximum deduction in any one year is 20% of the taxpayer's income. The amendments to these paragraphs extend the carry-forward period from one year to five years. As amended, these paragraphs allow charitable donations to be deducted in the taxation year they were made or in any of the five subsequent taxation years to the extent that they were not deductible in a previous year. A further amendment adding subsection 110(1.2) of the Act deals with the treatment of charitable donations in the year of death by allowing, in such a case, a one-year carry-back. These amendments apply with respect to gifts made in the 1981 and subsequent taxation years.

Subclause 65(3)

ITA
110(1)(c)(viii.1)

Paragraph 110(1)(c) of the Act contains a list of expenditures which qualify as deductible medical expenses. Subparagraph 110(1)(c)(viii.1) provides for the deduction of certain transportation expenses incurred to obtain medical services. To qualify, the transportation must be at least 25 miles from the locality in which the patient resides. The amendment to this subparagraph converts the distance expressed in miles to its metric equivalent. The reference to "40 kilometres" replaces the former reference to "25 miles", effective for payments made after 1981.

Subclause 65(4)

ITA
110(1)(c)(viii.2)

Subparagraph 110(1)(c)(viii.2) is a new provision. It extends the expenses described in paragraph 110(1)(c) of the Act which qualify for deduction as medical expenses. Reasonable travelling expenses incurred in respect of a patient and his attendant in order to obtain medical services in a place at least 80 kilometres away from the patient's residence now qualify for deduction as a medical expense provided such services are not available in the patient's locality and certain other conditions are met. The amendment, which applies to the 1982 and subsequent taxation years, benefits persons living in remote areas who must travel substantial distances for medical attention.

Subclauses 65(5) and (6)

ITA 110(1)(f)

Paragraph 110(1)(f) of the Act permits a deduction, in computing taxable income, for the old age supplement under the *Old Age Security Act* or its provincial equivalent where it has been included in income. The result is that such amounts are not taxed but, because they are included in income, are relevant in determining whether the recipient may be claimed as a dependant by another taxpayer.

Paragraph 110(1)(f) is amended to extend the same treatment to certain other payments. Amendments to subsections 56(1) and 81(1) of the Act require workmen's compensation payments, social assistance payments, and amounts received by an individual that are exempt from income tax by virtue of a tax treaty to be included in computing income. Subparagraphs 110(1)(f)(i), (ii) and (iii) provide for the deduction of these amounts from income in computing taxable income.

ITA 110(1)(g)

Paragraph 110(1)(g) of the Act provides for the deduction of a special student allowance in computing taxable income. The deduction is $50 per month for each month in which the student was in full-time attendance at a designated educational institution and enrolled in a qualifying educational program. The expression "designated educational institution" is defined in paragraph 110(9)(a) of the Act and includes an institution that is certified by the Minister of Employment and Immigration as one providing vocational training. The education deduction is intended to apply in respect of post-secondary education and vocational, employment-oriented training. Many of the certified institutions provide both vocational courses and other courses which are not employment-oriented. The definition of a "qualifying educational program" for such an institution was previously restricted only by reference to the amount of time spent by the student in the program and not by the course content.

Paragraph 110(1)(g) of the Act is amended so that students attending an educational institution certified by the Minister of Employment and Immigration will qualify for the special student allowance only if they are enrolled in a program to obtain or improve their occupational skills.

ITA 110(1)(h)

Paragraph 110(1)(h) of the Act provides that where a student does not have enough income to claim all of the special student allowance deduction under paragraph 110(1)(g) for which he qualifies, the unused amount may be claimed by his relative who is a "supporting individual" as defined in paragraph 110(9)(c) of the Act. Paragraph 110(1)(h) of the Act is amended to ensure that this unused deduction can be claimed by the supporting individual only if the student is enrolled in a program to obtain or improve his occupational skills.

The amendments to paragraphs 110(1)(f), (g) and (h) apply to the 1982 and subsequent taxation years.

Subclause 65(7)

ITA 110(1.2)

Subsection 110(1.2) of the Act is a new provision which allows the undeducted portion of certain charitable contributions made by an individual in the year of death to be carried back one year. It applies with respect to gifts made in the 1981 and subsequent taxation years. To the extent that the amount of a charitable donation, a gift to the federal or a provincial government or a gift of certain cultural property is not deductible in the year of death, it may be deducted in the immediately preceding year. Since, under subsection 110(2.1) of the Act, gifts made by will are deemed to have been made by the individual in the year of death, such gifts will also qualify for the one-year carry-back.

Subclause 65(8)

ITA 110(4)

Subsection 110(4) of the Act provides an ordering rule for the deduction of charitable donations. Under this rule, donations carried forward from previous years are deducted under paragraphs 110(1)(a) and (b) before donations made in the current taxation year become deductible. Subsection 110(4) is amended to extend its application to gifts of certain cultural property that are deductible under paragraph 110(1)(b.1) of the Act. It is also amended to reflect the extension from one year to five years for the carry-forward period in respect of charitable donations, gifts to the federal or a provincial government and gifts of certain cultural property. This amendment applies to gifts made in the 1981 and subsequent taxation years.

Subclause 65(9)

ITA 110(6.1)

Subsection 110(6.1) is added to the Act as a consequence of the addition of new subparagraph 110(1)(c)(viii.2) which provides that reasonable travelling expenses incurred by persons living in remote areas in order to obtain medical services qualify as a deductible medical expense. Where such travelling expenses are paid by the taxpayer's employer, the amount so paid is included in the taxpayer's income as a benefit from employment. Subsection 110(6.1) allows the employee to treat any amount so included in income as a medical expense. This amendment applies to the 1982 and subsequent taxation years.

Subclause 65(10)

ITA 110(9)(a)(i)(B)

Paragraph 110(9)(a) of the Act defines a "designated educational institution" for purposes of the $50 per month education deduction provided in paragraphs 110(1)(g) and (h) of the Act. The amendment to clause 110(9)(a)(i)(B) modifies the certification requirements to ensure that the institution provides courses to furnish or improve the student's occupational skills. Institutions which provide courses designed for university credit have been removed from clause (B) since these are covered elsewhere in the definition of "designated educational institution". This amendment applies to the 1982 and subsequent taxation years.

Subclauses 65(11), (12) and (13)

These set out the effective dates for the amendments to section 110 of the Act.

$1,000 Investment Income Exemption

Clause 66

ITA 110.1(3)(a) and (c)

Section 110.1 of the Act provides the $1,000 exemption for interest, dividends, capital gains and certain other categories of investment income. Subsection 110.1(3) of the Act provides that certain payments under annuity contracts and life insurance policies may be included in the income that qualifies for this exemption. The amendments to subsection 110.1(3), applicable to the 1983 and subsequent taxation years, are consequential on the amendments to the provisions of the Act relating to the taxation of income on annuities and life insurance policies. Paragraph 110.1(3)(a) now refers to those annuities to which the amended paragraph 56(1)(d) of the Act applies. Paragraph 110.1(3)(c) refers to those annuities and life insurance policies to which the new accrual rules apply.

$1,000 Pension Income Exemption

Clause 67

Subclause 67 (1)

ITA
110.2(2)

Section 110.2 of the Act provides the $1,000 pension income deduction. The deduction for individuals under 65 years of age is provided under subsection 110.2(2), but the requirements of this provision are more stringent than the requirements under subsection 110.2(1) for those who are 65 or older. The amendment to subsection 110.2(2) further restricts the availability of the pension income deduction for those individuals under 60 years of age who are not in receipt of a disability or survivor's pension under the Canada Pension Plan or a similar provincial pension plan. The deduction will no longer be available to such an individual who has deducted an amount under paragraph 60(j) of the Act in respect of pension benefits or benefits received from a deferred profit sharing plan (other than certain lump sum payments out of a deferred profit sharing plan) which have been rolled over into a registered retirement savings plan or a registered pension plan. This amendment applies to the 1982 and subsequent taxation years.

Subclause 67 (2)

ITA
110.2(3)(a) and (b)

Paragraphs 110.2(3)(a) and (b) of the Act define "pension income" and "qualified pension income" for purposes of the $1,000 pension income deduction. A number of amendments are made to paragraph 110.2(3)(a) relating to the types of income which qualify as "pension income". As a result of the amendments, payments out of a superannuation or pension plan will qualify for the pension income deduction only if they are annuity payments; lump sum payments from such plans will no longer be eligible for the deduction.

The definition of pension income has also been amended to reflect the new rules relating to the treatment of annuity income under paragraphs 56(1)(d), (d.1), (d.2) and 60(a) of the Act. Annuity income described in paragraph 56(1)(d) or (d.1) of the Act qualifies for the pension income deduction where the taxpayer is age 65 or over, unless he has elected that the amount be treated as interest income for purposes of the $1,000 investment income deduction under subsection 110.1(1) of the Act. In addition, the amendment provides that accrued income on an annuity or life insurance policy that is included in income under section 12.2 of the Act and any annuity payment included in income under paragraph 56(1)(d.2) of the Act will qualify as pension income for the purposes of the $1,000 pension income deduction.

The amendments to the definition of "qualified pension income" in paragraph 110.2(3)(b) of the Act are consequential on changes made in the definition of pension income in paragraph 110.2(3)(a) of the Act.

These amendments apply to the 1982 and subsequent taxation years.

Subclause 67(3)

This sets out the effective date for the amendments to section 110.2 of the Act.

Transfer of Unused Deductions

Clause 68

ITA 110.3(a)

Section 110.3 of the Act provides for the deduction by a taxpayer in computing taxable income of certain deductions which his spouse has been unable to use. The deductions which are eligible for transfer to the taxpayer from his spouse are the $1,000 investment income deduction (section 110.1), the $1,000 pension income deduction (section 110.2), the age deduction (paragraph 109(1)(h)), the deduction for persons who are blind or confined to a bed or wheelchair (paragraph 110(1)(e)) and the education deduction (paragraph 110(1)(g)).

Under the existing rules, the taxpayer may claim the amount of such deductions which are in excess of the amount required by his spouse to reduce her taxable income to nil. The amendment to paragraph 110.3(a) allows the taxpayer to deduct his spouse's unused investment income and pension income deductions only to the extent that the married exemption otherwise available to him under paragraph 109(1)(a) of the Act is reduced by virtue of his spouse's income. If, for example, the spouse's only income in 1982 consisted of $900 of interest eligible for the investment income deduction, the married exemption available to the taxpayer would be reduced by $350 since any spousal income exceeding $550 reduces the taxpayer's married exemption. As a result of the amendment, only $350 of the spouse's unused deduction in this example may be transferred in 1982 to the taxpayer. Before its amendment, section 110.3 of the Act would have allowed the full $900 of unused deduction to be transferred to the taxpayer. This amendment applies to the 1982 and subsequent taxation years.

Forward Averaging

Clause 69

ITA
110.4

Sections 110.4 and 120.1 of the Act are new provisions which, taken together, set out the rules relating to the new system of forward averaging. Forward averaging replaces the income-averaging annuity contract and the former system of general averaging. Under the new rules, an individual may elect to pay a refundable tax at his maximum marginal rate on an eligible amount determined on the basis of his average income for the three previous years. In the case of artists, entertainers and athletes, the full amount of income from artistic, entertainment and athletic activities is eligible for averaging. All or part of the amount averaged may be brought into income in any subsequent taxation year, at which time it may be subject to tax at a lower rate, and credit will be given in respect of the tax previously paid. Both the amount averaged and the refundable tax paid are indexed by reference to changes in the Consumer Price Index.

ITA
110.4(1)

Subsection 110.4(1) of the Act restricts the right to forward average to an individual (other than a trust) who was resident in Canada throughout the year (referred to as the "year of averaging") and the two immediately preceding years. (For 1982, the individual is required to be a resident Canadian throughout that year and the immediately preceding taxation year only.) The amount of income eligible for forward averaging is determined under subsection 110.4(1) and is the greater of two amounts, not to exceed the taxpayer's taxable income before averaging. The first amount is the aggregate of the taxpayer's income from artistic, entertainment and athletic activities plus one-half of the excess of capital gain reserves brought into income over reserves deducted. The second amount is the excess of the taxpayer's income for the year over 110% of the average of the taxpayer's "adjusted income" for the three immediately preceding taxation years. "Adjusted income" is defined in paragraph 110.4(8)(b) to be the taxpayer's income for the year indexed by reference to the Consumer Price Index. The amount which the taxpayer elects to forward average is deducted in computing his taxable income. A taxpayer may not elect an amount that is less than $1,000. The election is made by the filing of a prescribed form with his tax return within the time limit specified for filing his return.

ITA
110.4(2)

When a taxpayer has elected, under subsection 110.4(1), to forward average an amount in any previous taxation year, subsection 110.4(2) enables him to elect to bring into his taxable income in any subsequent taxation year throughout which he was resident in Canada all or part of his "accumulated averaging amount" at the end of the preceding year. The election must be made in prescribed form with his tax return within the time limit specified for filing his return. "Accumulated averaging amount" is defined in paragraph 110.4(8)(a) of the Act. This amount is calculated on a cumulative basis and is equal to the total of all averaging amounts previously deducted in computing his taxable income under subsection 110.4(1) minus the total of all such amounts previously brought into his taxable income under subsection 110.4(2), all indexed in accordance with the Consumer Price Index.

ITA
110.4(3)

Subsection 110.4(3) of the Act ensures that a taxpayer may not elect to deduct from taxable income and average any amount under subsection

110.4(1) in a year during which he was bankrupt. Such a taxpayer may, however, add to his taxable income under subsection 110.4(2) any amount which he elected to average in a preceding taxation year and thereby obtain any refund of tax to which he is entitled.

ITA
110.4(4)

Subsection 110.4(4) of the Act ensures that the elections under subsections 110.4(1) and (2) can be made in respect of an individual who dies during the taxation year. This provision is necessary since the elections for a year under subsections 110.4(1) and (2) are otherwise available only to an individual who was resident in Canada throughout the year.

ITA
110.4(5)

Subsection 110.4(5) of the Act provides that income included on certain separate income tax returns provided for in subsections 70(2) and 150(4) and paragraph 104(23)(d) of the Act may not be forward averaged. These provisions refer to the special separate returns filed in the year in which a taxpayer dies.

ITA
110.4(6)

Subsection 110.4(6) of the Act provides that an election by the taxpayer under subsection 110.4(1) to forward average an amount will not be valid unless the taxpayer pays within 30 days of the first notice of assessment the full amount of tax, interest and penalties for which he is assessed for the year of averaging. He must also have filed an income tax return for each of the three (or in some cases, fewer) immediately preceding taxation years or, where no income tax was payable for such a year and no return was filed, a form containing certain prescribed information.

ITA
110.4(7)

Subsection 110.4(7) of the Act provides for the situation where a taxpayer elects to forward average an amount which is in excess of the amount eligible under subsection 110.4(1). This may happen, for example, where a loss realized in a subsequent taxation year is carried back to the year of averaging. The excess amount is, in effect, added back to taxable income for the year of averaging and the tax paid by the taxpayer under subsection 120.1(2) in respect of this excess amount is credited against his tax liability for that year.

ITA
110.4(8)

Subsection 110.4(8) of the Act provides the definitions of "accumulated averaging amount" and "adjusted income" for purposes of sections 110.4 and 120.1. These definitions are discussed in the commentary on subsections 110.4(1) and (2) of the Act.

Section 110.4 is effective for the 1982 and subsequent taxation years.

Corporate Loss Carryovers

Clause 70

Subclause 70(1)

ITA 111(5), (5.1), (5.2), (5.3) and (5.4)

Under paragraph 111(1)(a) of the Act, any non-capital losses of a taxpayer not deducted in the year in which they are incurred may be carried back one year and forward for five years. Under the existing rules, where the taxpayer is a corporation and control of the corporation is changed, subsection 111(5) limits the circumstances in which a deduction may be claimed for its non-capital losses from carrying on a business in taxation years ending before control changed. In calculating its taxable income for a taxation year ending after a change of control, a corporation may not deduct non-capital losses derived from carrying on a business in a previous year where it did not carry on that business during the year in which it seeks to deduct the loss or where its control changed after the business was discontinued or wound up.

The amendments to subsection 111(5) of the Act provide new tests for the carry-forward of non-capital losses of a corporation incurred in carrying on a particular business. After control changes, any non-capital loss of the corporation incurred in carrying on a particular business for a taxation year ending before the change is deductible only if the particular business is carried on to the end of the taxation year during which control changed. In addition, the business must be carried on for profit or with a reasonable expectation of profit. Where these conditions are met, losses incurred prior to the change of control may be deducted to the extent of the aggregate of the two amounts described in paragraph 111(5)(b). The first such amount is the corporation's income for the year from the business in which the loss was sustained plus its income from any other business substantially all of whose income is derived from activities similar to those carried on in the loss business. The second such amount is the amount by which the corporation's taxable capital gains for the year from the disposition of certain property owned by it at the time of the change of control exceeds its allowable capital losses, net of its allowable business investment losses, from such dispositions.

New subsections 111(5.1) and 111(5.2) of the Act extend the loss carry-forward rules to encompass certain unrealized losses. Subsection 111(5.1) provides that where, at the time of change of control of a corporation, the fair market value of all the depreciable property of a prescribed class is less than its undepreciated capital cost, the difference is deemed to have been claimed by the corporation as capital cost allowance in previous taxation years. The difference is treated as a non-capital loss of the corporation for the taxation year immediately preceding the year in which control changed. Subsection 111(5.2) provides analogous treatment in respect of eligible capital property. A non-capital loss arising as a consequence of these rules is subject to the carry-forward restrictions described in the commentary on subsection 111(5).

Subsections 111(5.1) and (5.2) provide for cases where a non-capital loss arises in the year immediately preceding the year in which control changes. Subsection 111(5.3) provides the special rule necessary to deal with the circumstances where a change of control occurs in the first year of the corporation.

New subsection 111(5.4) should be read together with the amended subsection 88(1.1) of the Act. Where a subsidiary corporation has been wound up into its parent, subsection 88(1.1) provides that the parent corporation may deduct non-capital losses of the subsidiary incurred before the winding-up. However, where control of either corporation has changed, any non-capital losses of the subsidiary which arose from carrying on a business before the change of control are subject to restrictions similar to those provided in subsection 111(5). Subsection 111(5.4) is designed to ensure that where a subsidiary which had losses was wound up into its parent before the introduction of the new rules, and where control of the parent subsequently changes, the carry-forward restrictions provided in subsections 111(5) and 88(1.1) as amended apply to such losses.

Subsection 111(5) as amended and new subsections 111(5.1), (5.2) and (5.3) apply, subject to certain transitional provisions, to changes of control after November 12, 1981. New subsection 111(5.4) applies after November 12, 1981.

Subclauses 70(2) and (3)

These set out the effective date for the amendments to section 111 of the Act.

Dividends Received by Corporations Resident in Canada

Clause 71

Subclause 71(1)

ITA
112(1)(b)

Subsection 112(1) of the Act provides that, in computing its taxable income, a corporation may deduct dividends received by it from a taxable Canadian corporation or from a resident corporation controlled by it (other than a non-resident-owned investment corporation). Paragraph 112(1)(b) is amended to deny the deduction for dividends received after November 12, 1981 from a controlled resident corporation where such a corporation is tax-exempt.

Subclause 71(2)

ITA
112(2.2)(g)

Subsection 112(2.2) of the existing Act denies a deduction for dividends received on certain shares where there is a purchase or repurchase agreement with a financial institution that is designed to limit the shareholder's loss. Paragraphs 112(2.2)(c) to (f) exclude certain shares from the application of this rule. New paragraph 112(2.2)(g) is added to provide the authority to identify in the Income Tax Regulations other shares to which the denial of the dividend deduction will not apply. This amendment applies to dividends received after October 23, 1979.

Subclause 71(3)

ITA
112(2.3)

Subsection 112(2.3) is a new provision which denies a deduction to a corporation in respect of a dividend received by it on a "short-term preferred share" unless, at the time of payment of the dividend, the corporation was not dealing at arm's length with the payor corporation. For this purpose, corporations will not be considered to be dealing with each other on a non-arm's length basis solely by virtue of an option or other right described in paragraph 251(5)(b) of the Act. The expression "short-term preferred share" is defined in subsection 248(1) of the Act. In general terms, it means a preferred share with a term of 18 months or less that was issued in lieu of commercial paper to obtain short-term funds. This amendment applies to dividends received after November 12, 1981.

Subclause 71(4)

ITA
112(3)

Subsection 112(3) of the existing Act provides what is generally referred to as a "stop-loss" rule. It reduces the loss of a corporation on the sale of a share by the amount of tax-free dividends received on the share. The rule does not apply where the corporation owned the share 365 days or longer and did not own more than 5% of the shares of any class of the capital stock of the corporation paying the dividend. The amendment to subsection 112(3) alters the 5% share-ownership test to apply, not only where the corporation itself owns the shares, but also where the corporation and other non-arm's length persons own in the aggregate more than 5% of the shares of any class of the corporation on which dividends were paid. This subsection is also amended to refer to dividends paid out of the life insurance capital dividend account for the purpose of the stop-loss rule. This amendment applies to dispositions occurring after November 12, 1981.

ITA
112(3.1) and (3.2)

Subsections 112(3.1) and (3.2) are added to the Act to extend the stop-loss rule provided in subsection 112(3) to the loss of a corporation with respect to shares held by a partnership or trust of which it is a partner or beneficiary. Subsection 112(3.1) reduces a corporate partner's share of the partnership's loss on the sale of a share by the amount of taxable dividends, capital dividends and life insurance capital dividends attributed to the corporation on the share. This stop-loss rule will not apply where the partnership held the share 365 days or longer and the partnership, the corporate partner and persons not dealing at arm's length with the corporate partner did not hold more than 5% of the shares of any class of the corporation paying the dividend. Subsection 112(3.2) provides a similar rule with respect to losses on shares owned by a trust of which a corporation is a beneficiary. These amendments apply with respect to losses on the disposition of shares after November 12, 1981.

Subclause 71(5)

ITA
112(4)(b)

Subsection 112(4) of the existing Act extends the stop-loss rule provided in subsection 112(3) of the Act to losses on shares that are not capital property of the taxpayer. The amendments to subsection 112(4) correspond to those described in the commentary on subsection 112(3) relating to the 5% share-ownership test. These amendments apply to dispositions after November 12, 1981.

Subclause 71(6)

ITA
112(4.1)

Subsection 112(4.1) of the Act applies to a taxpayer who owns a share that is not a capital property. It specifies that, for purposes of inventory valuation, dividends received on the share must be added to the fair market value of the share otherwise determined, unless the taxpayer owned the share 365 days or longer and did not own more than 5% of the shares of any class of the corporation paying the dividend. Subsection 112(4.1) is amended to ensure that, after November 12, 1981, it will apply to shares held by a partnership or trust and to ensure that shares owned by non-arm's length persons will also be included for the purposes of the 5% share-ownership test. The amendments to subsection 112(4.1) apply to taxation years commencing after 1981.

ITA
112(4.2) and (4.3)

Subsections 112(4.2) and (4.3) are added to the Act to extend the stop-loss rules in subsection 112(4) to a loss arising with respect to shares held by a partnership or trust that are not capital property. Subsection 112(4.2) reduces a partner's share of the partnership's loss on a share that is not a capital property by the amount of dividends received by the partner on the share, unless the partnership held the share 365 days or longer and the partnership, the partner and persons not dealing at arm's length with the partner did not hold more than 5% of the shares of any class of the corporation paying the dividend.

New subsection 112(4.3) reduces the loss of a trust (other than a prescribed trust) on a share held by the trust that is not a capital property by the amount of dividends on the share allocated to a beneficiary of the trust, unless the trust owned the share 365 days or longer and the trust, the beneficiary and persons not dealing at arm's length with the beneficiary did not own more than 5% of the issued shares of any class of the corporation paying the dividend.

Subsections 112(4.2) and (4.3) apply to dispositions occurring after November 12, 1981.

Subclause 71(7)

ITA
112(7)

Subsection 112(7) of the Act provides special rules relating to the application of the stop-loss rule in subsection 112(3) where a new share has been acquired in exchange for another share on a conversion, a share-for-share exchange, a corporate reorganization or an amalgamation. The amendments to subsection 112(7) extend these special rules to apply to the new stop-loss rules provided in subsections 112(3.1) and (3.2) of the Act.

Subclauses 71(8) to (12)

These set out the effective dates for the amendments to section 112 of the Act.

Deduction for Dividends from Foreign Affiliates

ITA
113(1)

Clause 72

Subsection 113(1) of the Act permits a resident corporation to deduct prescribed amounts in respect of dividends received out of the exempt, taxable and pre-acquisition surplus of a foreign affiliate. This amendment to subsection 113(1) establishes the authority for the corporation to make such elections as may be provided in the Income Tax Regulations for the purpose of determining the portion of a dividend that is prescribed to have been paid out of its separate surplus accounts. The amendment applies to elections made after 1975.

Non-Residents' Taxable Income Earned in Canada

Clause 73

Subclause 73(1)

ITA
115(1)(a)(vi)

Subsection 115(1) of the Act determines the amount of the taxable income earned in Canada on which a non-resident is subject to taxation under Part I of the Act. Subparagraph (vi) is added to paragraph 115(1)(a) to include in taxable income earned in Canada any gain of a non-resident resulting from a disposition of an interest in a life insurance policy in Canada. A "life insurance policy in Canada" is a policy or annuity issued or effected upon the life of a person who was resident in Canada at the time it was issued or effected. If the non-resident was employed in Canada, carried on business in Canada or disposed of taxable Canadian property at any time in the year or in a previous year, the gain will be subject to tax by virtue of section 2 of the Act. A related amendment is made to subsection 116(5.2) of the Act to require the non-resident to obtain a certificate under that subsection or be subject to a 50% withholding tax under subsection 116(5.3) on the proceeds of disposition. This amendment applies to dispositions occurring after November 12, 1981.

Subclause 73(2)

ITA
115(1)(b)(ii) and (ii.1)

Subparagraph 115(1)(b) of the Act defines the expression "taxable Canadian property". Gains arising from the disposition of taxable Canadian property by a non-resident are subject to the Part I tax. Subparagraph 115(1)(b)(ii.1) is added to clarify that capital property described in paragraph 138(12)(l) of the Act that is held by a non-resident insurer will fall within the definition of taxable Canadian property. This amendment applies to dispositions of property occurring after November 12, 1981.

Subclause 73(3)

ITA
115(1)(d), (e) and (f)

In computing a non-resident's taxable income earned in Canada, subsection 115(1) of the Act allows such of the deductions provided in Division C (sections 109 to 113 of the Act) as may reasonably be considered wholly or partly applicable. The concluding words of subsection 115(1) are amended to limit, for the 1982 and subsequent taxation years, the deduction in respect of personal exemptions and certain other allowances. Under new paragraphs 115(1)(d) and (e), the deductions for charitable donations, gifts to the federal or a provincial government and gifts of certain cultural property, for blind persons and persons confined to a bed or wheelchair, for repayments of unemployment insurance benefits and for loss carry-overs will continue to be available for all non-residents. Under new paragraph 115(1)(f), only if all or substantially all the non-resident's income for the year is from employment in Canada or carrying on business in Canada or is a scholarship, bursary or research grant received by a former Canadian resident, will a non-resident be allowed other deductions such as those for personal exemptions, medical expenses and the $1,000 investment income and pension income deductions.

Subclauses 73(4) and (5)

ITA
115(2)(c.1) and (e)(v)

Paragraph 115(2)(c.1) and subparagraph 115(2)(e)(v) are added to the Act to include a signing bonus or similar payment received by the non-resident in his taxable income earned in Canada. The new provisions apply where an amount, which is deductible under the Act to the payor, is received by a non-resident under a contract as consideration for entering into a contract of or for services to be performed in whole or in part in Canada or as consideration for undertaking not to enter into any such contract with someone else—subparagraph (c.1)(i). The new provisions also apply to remuneration from employment or as compensation for services to be performed in Canada—subparagraph (c.1)(ii). These amendments apply to amounts received after November 12, 1981.

Subclauses 73(6) to (9)

These set out the effective dates for the amendments to section 115 of the Act.

Collection Procedures on Dispositions by Non-Residents

Clause 74

Section 116 of the Act establishes procedures for collecting tax from non-residents on the proposed or actual disposition of taxable Canadian property and Canadian resource properties. Generally, tax is required to be withheld by the purchaser except where a special certificate is provided by the non-resident and the required tax is paid.

ITA 116(5.1)

Subsection 116(5.1) of the Act is amended to extend the procedures provided in section 116 to the disposition of a life insurance policy in Canada. The expression "life insurance policy in Canada" is defined in paragraph 138(12)(g) of the Act. On the disposition of such a policy, a non-resident may be liable for tax under the Act in respect of any gain. Amendments to subsection 116(5.2) provide that the non-resident must obtain the required certificate from the Minister of National Revenue or be subject to a 50% withholding tax on the full proceeds of disposition of the policy under subsection 116(5.3).

Subsection 116(5.1) is also amended to replace the reference to "Canadian resource property" with a reference to "property described in paragraph 59(2)(a), (c) or (d)". The reference to "Canadian resource property" inappropriately limited the resource properties covered by this provision to those acquired by the non-resident after 1971.

ITA 116(5.2)

Subsection 116(5.2) of the existing Act applies to resource properties and depreciable property owned by a non-resident and sets out the certificate procedures for proposed dispositions. The amendment to this subsection allows a certificate to be obtained for completed dispositions as well as proposed dispositions. A further amendment to subsection 116(5.2) adds a "life insurance policy in Canada" to the types of property in respect of which a section 116 certificate may be obtained. The amendment also replaces the reference to "Canadian resource property" by a reference to "property described in paragraph 59(2)(a), (c) or (d)" of the Act. Subsection 116 (5.2), as amended, now permits a certificate to refer to an amount other than the actual or proposed proceeds of disposition in order to accommodate certain tax-deferred transfers to a corporation under subsection 85(1) of the Act.

ITA 116(5.4)

Subsection 116(5.4) is added to the Act to treat the insurer under a life insurance policy in Canada as having acquired the interest in the policy for purposes of subsections 116(5.2) and (5.3) when the disposition of a life insurance policy in Canada arises by virtue of a payment by the insurer. This ensures that the policyholder must then obtain an appropriate certificate from the Minister of National Revenue under subsection 116(5.2). In the absence of this certificate, the insurer will be required to withhold 50% of the proceeds and remit it to the Receiver General of Canada on behalf of the policyholder.

The amendments to section 116 of the Act are to be effective after Royal Assent has been given to this amending Bill.

Individual Tax Rates

Clause 75

Subclause 75(1)

ITA 117(5.1)

Subsection 117(5.1) of the existing Act establishes the tax rates that have applied to individuals since 1977. This subsection is amended so that it will not apply after 1981. The rates after 1981 are provided in new subsection 117(5.2).

Subclause 75(2)

ITA 117(5.2)

The addition of new subsection 117(5.2) to the Act establishes the individual tax rates for the 1982 and subsequent taxation years. Indexing, as provided in section 117.1 of the Act, will apply to these rates.

Subclause 75(3)

ITA 117(7)(b)

A taxpayer is entitled under paragraph 110(1)(c) of the Act to deduct medical expenses that were paid by him for a dependant in those circumstances where the taxpayer may claim a deduction for the dependant under section 109 of the Act. If the dependant's income for the year exceeds a threshold (computed by reference to a base amount of $1,700 in 1972 as indexed under section 117.1 of the Act), which for 1981 was $3,270, the taxpayer will be unable to deduct such medical expenses. In these circumstances, the taxpayer may take advantage of what is generally referred to as the "notch provision" in subsection 117(7) of the Act. Under the notch provision, the taxpayer may instead claim the medical expenses as a deduction provided he adds to his tax payable the amount by which the dependant's income exceeds the relevant threshold amount.

The amendment to paragraph 117(7)(b) of the Act, effective for the 1980 and subsequent taxation years, corrects a defect in the provision which had the effect of requiring the taxpayer to pay as tax significantly more than the dependant's excess income. By referring to 68% of the excess income, the amount in paragraph 117(7)(b) now equals the federal share of tax, and the addition of the appropriate provincial tax brings the total additional tax up to a level that approximates the excess income.

Subclause 75(4)

This sets out the effective dates of the amendment to section 117 of the Act.

Clause 76

ITA
117.1(1)(d)

Section 117.1 of the Act contains the provisions for indexing certain deductions and the individual income tax brackets. Paragraph 117.1(1)(d) is amended to add a cross-reference to the new individual income tax rate schedule in subsection 117(5.2) of the Act.

ITA
117.1(5)

The amendment to subsection 117.1(5) of the Act deletes the cross-reference to paragraph 118(3)(b) of the Act relating to general averaging. For the 1982 and subsequent taxation years, general averaging has been replaced by a new system of forward averaging as described in the commentary on sections 110.4 and 120.1 of the Act.

ITA
117.1(7.1)

Subsection 117.1(7.1) is added to the Act to limit the indexing adjustment for the personal exemptions and the individual income tax brackets for 1983 to 6% and for 1984 to 5%. Under the rule provided in paragraph 117.1(7)(c), the indexing adjustment for 1985 is to be determined by reference to the increase in the Consumer Price Index in the 12-month period ending September 30, 1984. The restriction of the indexing adjustment for the two years 1983 and 1984 will not apply for the purpose of determining the amount of the child tax credit as determined under section 122.2 of the Act.

General Averaging

Clause 77

ITA
118

Section 118 of the Act which provided general averaging for individuals is repealed for the 1982 and subsequent years. It is replaced by a new forward averaging system described in the commentary on sections 110.4 and 120.1 of the Act.

Block Averaging

Clause 78

ITA
119(6)

Section 119 of the Act permits what is generally referred to as five-year block averaging for determining the taxes payable by farmers and fishermen. Block averaging generally permits a farmer or fisherman to elect to calculate his tax on the basis of his average income over a five-year period. The amendment to subsection 119(6) continues the system of block averaging but provides that it will not apply if, in any year in the block averaging period, the taxpayer either added or deducted any amount in determining his taxable income under the new provisions relating to forward averaging in section 110.4 of the Act. This amendment applies to 1982 and subsequent taxation years.

Adjustments to Individual Income Tax

Clause 79

Subclause 79(1)

ITA 120(1)

Subsection 120(1) of the Act imposes an additional tax on an individual who has income that is not earned in the year in a province. This applies to foreign source business income of residents and to certain categories of income of non-residents. Subsection 120(1) is amended to increase the rate for the additional tax on income not earned in a province from 43% to 47% of the federal tax otherwise payable. This 47% rate approximates the average effective tax rate of those provinces with which the federal government has entered into tax collection agreements. It is the provincial rate implicit in a number of other provisions of the Act—for example, in section 121 relating to the calculation of the dividend tax credit. This amendment applies to the 1982 and subsequent taxation years.

Subclause 79(2)

ITA 120(3.1)

Subsection 120(3.1) of the Act allows a special federal tax reduction for individuals. For 1981 the amount of this reduction was 9% of the federal tax otherwise payable with a minimum of $200 and a maximum of $500. This subsection is amended to set this reduction at $200 for the 1982 and subsequent years. A further amendment to subsection 120(3.1) permits a taxpayer an additional federal tax reduction in a year for the portion of the $200 tax reduction not claimed by his spouse for the year. Thus, if a taxpayer's spouse did not have any tax otherwise payable for a year, the taxpayer would be entitled under subsection 120(3.1), as amended, to deduct $400 in computing his tax payable.

Subclause 79(3)

This sets out the effective date for the amendments to section 120 of the Act.

Clause 80

ITA
120.1

Section 120.1 is added to the Act as part of the new forward averaging rules described in the commentary on section 110.4 of the Act. Under forward averaging, a resident individual may elect in a year to pay a refundable tax at the top marginal rate (34% for 1982 plus the applicable provincial rate) on a portion of his income eligible for averaging. This elected amount is adjusted by reference to changes in the Consumer Price Index and the indexed amount can be brought back into taxable income in any subsequent year by the individual. While the amount is subject to tax in that later year, the taxpayer can claim a tax credit equal to the top marginal rate for that year multiplied by the indexed amount that he elected to bring into income.

ITA
120.1(1) and (2)

Section 120.1 sets out the calculation of what might be referred to as the forward-averaging tax and tax credits. Subsection 120.1(2) requires additional tax at the top marginal individual tax rate to be paid by the individual on the averaging amount that he elects to deduct from his income under subsection 110.4(1) for the year. Subsection 120.1(1) permits a credit against the tax otherwise payable by the individual for a year equal to the top marginal rate times the indexed averaging amount which the individual has elected under subsection 110.4(2) to include in his taxable income for the year. Where the credit exceeds tax otherwise payable, the excess is refunded to the taxpayer.

Paragraph 120.1(2)(b) sets out the rules that apply when a taxpayer dies at a time when he had an unclaimed accumulated averaging amount. In the year of death, the accumulated averaging amount not brought back into income in that year is taxed as if one-third of the amount thereof were added to his taxable income in each of the three years preceding the year in which he died. A tax credit against this tax is provided under subsection 120.1(1) equal to the accumulated averaging amount times the top marginal rate.

ITA
120.1(3)

Subsection 120.1(3) deals with the circumstance where on December 31 in any year the taxpayer is not resident in a province and is therefore not ordinarily subject to provincial income taxation. In these circumstances, the tax credit under subsection 120.1(1) and the tax added under subsection 120.1(2) are increased by 47%. This increase is set at the percentage referred to in subsection 120(1) of the Act and it ensures that the total tax additions and credits approximates the amount that would be the combined federal and provincial tax if the individual were resident in a province.

ITA
120.1(4) and (5)

The effect of subsection 120.1(4) is to permit the forward-averaging tax credit to which an individual is entitled in a year under subsection 120.1(1) to be refunded to the extent that it exceeds the amount of his tax otherwise payable for the year. Under subsection 120.1(5) the amount of the forward-averaging credit that is refunded in a year to an individual resident in the Province of Quebec on the last day of a taxation year is reduced by 16.5%. This is the aggregate of the special Quebec abatements—3% under subsection 120(2) of the Act and 13.5% under the special cost sharing arrangements relating to the financing of certain established programs.

ITA
120.1(6) and (7)

The rules provided in subsections 120.1(6) and (7) supplement those in paragraph 120.1(2)(b) relating to an individual who dies while resident in Canada. Subsection 120.1(6) provides a special rule where the individual was not resident in Canada throughout the three-year period before the year of death. In such cases, the tax computations required under paragraph 120.1(2)(b) are to be made on the assumption that the individual was resident in Canada and had paid Canadian tax on his total income for those years. Subsection 120.1(7) stipulates that the provisions of section 120.1 will not be available in respect of such an individual unless his legal representatives prepare and file personal income tax returns for the individual as if he had been so resident. This information is necessary to permit the calculation to be made of the forward-averaging credit to which the individual's heirs or estate may be entitled for the year in which the individual died.

ITA
120.1(8)

Subsection 120.1(8) is a special provision to ensure that the addition to tax under subsection 120(1) for income not earned in a province and the deductions from tax under section 121 and subsection 120(3.1) in respect of the dividend tax credit and the federal tax reduction are calculated on the assumption that "tax otherwise payable" does not include any tax added or deducted under section 120.1.

The new section 120.1 of the Act is applicable to the 1982 and subsequent taxation years.

Dividend Tax Credit

Clause 81

ITA 121

Section 121 of the Act is part of the gross-up and tax credit mechanism for the taxation of dividends received by individuals from taxable Canadian corporations. In general terms, a dividend received by an individual shareholder is grossed up by one-half and the grossed-up dividend is included in the recipient's income under paragraph 82(1)(b) of the Act. The amount of the gross-up—that is, one-half the dividend—is intended to qualify as a tax credit against the federal and provincial taxes payable by the individual. The federal share of the dividend tax credit is provided in section 121 of the Act. For 1981 the federal dividend tax credit under this section was 3/4 of the amount of the dividend gross-up. Section 121 is amended for 1982 and subsequent years to provide a federal credit of 68% of the amount of the gross-up. The amount of the provincial dividend tax credit will vary from province to province and depend on the rate of the provincial tax. However, when provincial taxes are taken into account, the total dividend tax credit, federal and provincial taken together, will approximate one-half of the actual dividend received.

Tax Rates for Certain Trusts

Clause 82

ITA
122

Section 122 of the Act establishes the tax rate for *inter vivos* and mutual fund trusts. The amendments to this section reduce the percentages referred to in subsection 122(1) relating to *inter vivos* trusts and in subsection 122(3) relating to mutual fund trusts from 35% to 34%. These amendments apply for the 1982 and subsequent taxation years. These rate changes are consequential on the amendments to section 117 of the Act which reduce the maximum marginal rate of federal tax for individuals to 34% for 1982 and subsequent years.

Child Tax Credit

Clause 83

ITA
122.2(1) (c)

Section 122.2 of the Act provides a child tax credit which is available to a person, usually the child's mother, entitled to receive family allowances in respect of the child. Under the existing section, the amount of the child tax credit is $200 as adjusted for an indexing factor. The indexed $200 is multiplied by the number of eligible children to determine the total amount of credit. For the 1982 taxation year, the indexed amount for each eligible child is $293. The total amount of credit is then reduced by 5% of the family income in excess of the family income threshold which, for 1982, is $26,330. The amendment to paragraph 122.2(1)(c) increases the amount of the child tax credit for 1982 by $50 to $343 for each eligible child, in order to offset for recipient families the capping of the indexing in family allowances at 6% for 1983.

Corporate Surtax for 1980 and 1981

Clause 84

ITA
123.3(a) and (b)

Section 123.3 of the Act imposes a 5% surtax for the 1980 and 1981 calendar years on the federal tax payable by corporations. Section 123.4 has been added to the Act to extend the 5% surtax in modified form to the 1982 calendar year. The amendments to paragraphs 123.3(a) and (b) are consequential on the introduction of the separate 1982 surtax in section 123.4. These amendments exclude the 1982 surtax for the purpose of determining the tax upon which the 1981 surtax is imposed. These amendments are necessary to accommodate corporations with 1982 "straddle" years—that is, those corporations with 1982 taxation years which include periods in both the 1981 and 1982 calendar years.

1982 and 1983 Corporate Surtax

Clause 85

ITA
123.4
123.5

A surtax of 5% of federal corporate tax otherwise payable applied under section 123.3 of the Act for the 1980 and 1981 calendar years. Section 123.4 is added to the Act to extend the corporate surtax for the 1982 calendar year at a rate of 5% of taxes otherwise payable. Section 123.5 is also added to the Act to extend the corporate surtax for the 1983 calendar year at a 2½% rate. There is a special exclusion for these 1982 and 1983 surtaxes—the surtaxes for these years are not imposed on the tax payable by a Canadian-controlled private corporation with respect to income eligible for the small business deduction.

A related amendment is made to subsections 136(1) and 137(7) of the Act so that certain private cooperative corporations and credit unions are treated as Canadian-controlled private corporations for purposes of the special exclusions from the 1982 and 1983 surtaxes.

Small Business Deduction

Clause 86

Section 125 of the Act contains the rules for the small business deduction of Canadian-controlled private corporations that carry on an active or a non-qualifying business in Canada. The principal amendments to section 125 increase the limits for income qualifying for the small business deduction, limit the cases where dividends reduce the cumulative deduction account of a corporation and introduce the concept of a personal services business.

Subclause 86(1)

ITA
125(2)(a) and (b)

Subsection 125(2) defines the "business limit" and the "total business limit" of a corporation, for the purpose of the small business deduction. Paragraphs 125(2)(a) and (b) are amended, applicable for the 1982 and subsequent taxation years, to increase the business limit from $150,000 to $200,000 and the total business limit from $750,000 to $1,000,000. As a result, income of up to $200,000 a year from an active or a non-qualifying business may qualify for the low rate of corporate tax to the extent that the corporation's cumulative deduction account does not exceed $1,000,000.

Subclauses 86(2) and (3)

ITA
125(3)(a)(i) and (ii)
125(4)(a) and (b)

Canadian-controlled private corporations that are associated in taxation years ending in the same calendar year must share the business limit and the total business limit and, consequently, the small business deduction. The allocation involves filing a prescribed agreement under subsection 125(3) or, if an agreement is not filed, the Minister of National Revenue may make the allocation under subsection 125(4). Subparagraphs 125(3)(a)(i) and (ii) and paragraphs 125(4)(a) and (b) of the Act are amended to reflect the increases of the business limit and total business limit to $200,000 and to $1,000,000 respectively for the 1982 and subsequent taxation years.

Subclause 86(4)

Paragraph 125(6)(b) of the Act defines the cumulative deduction account of a corporation. Under the existing Act, this account represents a record of the total post-1971 business income accumulated by the corporation. This account is compared with the corporation's total business limit so that when it reaches $1,000,000, the corporation ceases to qualify for the small business deduction. There are a number of amendments to paragraph 125(6)(b).

ITA
125(6)(b)(iii)

Business income may be earned directly or effectively received by way of dividends from other corporations. To recognize this, dividend income is included in the recipient's cumulative deduction account at its pre-tax business income equivalent. These pre-tax equivalents are determined on the assumptions that active business income is taxed at a rate of 25% and non-qualifying business income at a rate of 33 1/3% with the result that the gross-up factors for dividends are set respectively at 4/3 and 3/2 for active business income and non-qualifying business income.

As discussed in the commentary on new sections 181 and 182, the corporate distributions tax has the effect of raising the implicit corporate tax rate on distributed active business income to 33 1/3% from 25%. As a result, the appropriate gross-up factor for dividends subject to the corporate distributions tax becomes 3/2 instead of 4/3. The amendments to subparagraph 125(6)(b)(iii) are consequential on this change. As in the past, dividends received from investment income are excluded from the cumulative deduction account. This is accomplished by applying the 3/2 factor only to the extent that the dividends exceed 4 times the Part IV tax paid in respect of the dividends.

Under paragraphs 186(1)(c) and (d) of the Act, a corporation may apply its non-capital losses to reduce the amount of dividends on which the Part IV tax is payable. However, where a corporation applies its non-capital losses in this manner, its cumulative deduction account is inappropriately increased since the dividends are not subject to the Part IV tax. An amendment to subparagraph 125(6)(b)(iii) corrects this technical deficiency. It effectively permits a corporation to deduct any such non-capital losses from the dividends it has received.

These amendments are effective for the purpose of computing the cumulative deduction account for the 1982 and subsequent taxation years.

ITA
125(6)(b)(iii.1)

Under the existing Act, a corporation that commences or ceases to carry on a non-qualifying business is required to adjust its cumulative deduction account in recognition of the change in the appropriate 4/3 or 3/2 gross-up factor that will subsequently apply to its dividends. Since, as a general rule, dividends paid by a corporation after 1981 will no longer reduce its cumulative deduction account, these adjustments are no longer required. The amendments to subparagraphs 125(6)(b)(iii.1) and (iv.1) provide one-time adjustments to be made in a corporation's 1983 taxation year so as to reverse the effect of the previous adjustments. These 1983 adjustments are to be set out in the Income Tax Regulations.

ITA
125(6)(b)(iii.2)

New subparagraph 125(6)(b)(iii.2) of the Act is consequential on the introduction of subsections 125(8.1) and (8.4) of the Act. These subsections set out adjustments to the cumulative deduction account on certain non-arm's length transfers of a business and dispositions of shares.

Subclause 86(5)

ITA
125(6)(b)(iv)

Subparagraph 125(6)(b)(iv) of the Act reduces the cumulative deduction account of a corporation by qualifying taxable dividends paid out of its active or non-qualifying business earnings. As with subparagraph 125(6)(b)(iii), subparagraph 125(6)(b)(iv) is amended as a result of the new 12½% corporate distributions tax so that a 3/2 factor replaces the 4/3 adjustment factor for dividends paid by the corporation to the extent that they were subject to the corporate distributions tax. This amendment applies for purposes of computing the cumulative deduction account for the 1982 and subsequent taxation years.

ITA
125(6)(b)(iv. 1)

The amendment to subparagraph 125(6)(b)(iv. 1) of the Act is explained in the commentary on the amendment to subparagraph 125(6)(b)(iii. 1).

ITA
125(6)(b)(iv.2)

New subparagraph 125(6)(b)(iv.2) of the Act is consequential on the introduction of new subsections 125(8.5) and (8.6). These subsections set out adjustments to the cumulative deduction account on certain non-arm's length share transactions.

Subclause 86(6)

ITA
125(6)(c)

Paragraph 125(6)(c) of the Act defines the expression "qualifying taxable dividends paid". Such dividends reduce the payor corporation's cumulative deduction account. Effective after 1981, the amendments to this paragraph effectively limit these dividends to those paid out of business income to an associated Canadian-controlled private corporation. As such, neither dividends on which the recipient is required to pay Part IV tax nor dividends paid to individuals or non-associated corporations will qualify.

Subclauses 86(7), (8) and (9)

ITA
125(6)(d) and (f)

The definitions of "active business" and "non-qualifying business" in paragraphs 125(6)(d) and (f) of the Act are amended to exclude a "personal services business" as defined in new paragraph 125(6)(g. 1). The effect of these amendments is to deny the small business deduction in respect of income from a personal services business.

ITA
125(6)(g)

The amendment to paragraph 125(6)(g), which defines "income of the corporation for the year from a non-qualifying business", simply relocates the quotation marks that identify the expression being defined.

ITA
125(6)(g. 1)

New paragraph 125(6)(g. 1) of the Act defines the expressions "personal services business" and "incorporated employee". These new definitions deal with situations where a corporation has been interposed in what would normally constitute an employee-employer relationship. As a general rule, a corporation is treated as carrying on a personal services business where a specified shareholder of the corporation provides services to an entity that, in the absence of the corporation, could reasonably be regarded as the services of an officer or employee of the entity. An exception is provided where the corporation employs more than 5 full-time employees who are not specified shareholders or related to such shareholders or where the services are provided to an associated corporation. Income from carrying on a personal services business is not eligible for the small business deduction. Further, as discussed in the commentary on paragraph 18(1)(p) of the Act, there is a restriction on the expenses that are deductible by the corporation in computing its income from such a business.

The amendments to these paragraphs apply to taxation years commencing after November 12, 1981.

Subclauses 86(10) and (11)

ITA 125(6)(i)

A corporation that is a member of a partnership or a group of connected partnerships must share a "specified limit" in respect of the partnership or group of partnerships. The specified limit is comparable to the $200,000 business limit that is shared by associated corporations. The amendments to paragraph 125(6)(i) increase the specified limit to $200,000 from $150,000 in line with the increase in the business limit. These amendments apply to fiscal periods of partnerships coinciding with, or ending in, the 1982 and subsequent taxation years of the corporation.

Subclause 86(12)

ITA 125(6.1) to (6.3)

New subsections 125(6.1) to (6.3) of the Act set out special rules for the purposes of calculating the cumulative deduction account of a corporation with respect to taxable dividends, the Part IV tax and dividend refunds.

ITA 125(6.1)

Subsection 125(6.1) applies in the case of a transfer of property to which new subsection 125(8.4) applies, or a transfer of a business, or certain share transactions, to which new subsection 125(8.1) applies. Subsection 125(6.1) of the Act requires certain items which may arise on these transactions—namely, taxable dividends paid, taxable dividends received, the Part IV tax paid and any dividend refund—to be ignored in calculating a corporation's cumulative deduction account. Subsections 125(8.1) and (8.4) provide separate adjustments to the cumulative deduction account in these circumstances.

ITA 125(6.2)

New subsection 125(6.2) of the Act introduces rules which apply in calculating a corporation's cumulative deduction account for taxation years ending after 1982. These rules apply when taxable dividends are paid to or received from an associated corporation that carried on a non-qualifying business. They ensure that the decrease in the cumulative deduction account of the payor corporation equals the increase in the cumulative deduction account of the recipient.

ITA 125(6.3)

New subsection 125(6.3) of the Act provides a rule for the purpose of computing the cumulative deduction accounts where dividends are paid between associated corporations and their taxation years end in different calendar years. In these circumstances, the dividend (and any related tax under Part IV or dividend refund) is treated as having been paid and received on the first day of the calendar year following the calendar year in which the dividend was actually paid. This rule, applicable for the 1982 and subsequent taxation years, ensures that the adjustments to the cumulative deduction accounts of both the payor and recipient corporations occur at the same time.

Subclause 86(13)

ITA 125(8.1) to (8.6)

Subsections 125(8.1) to (8.6) of the Act set out rules for computing the cumulative deduction account when certain non-arm's length property transfers, business transfers and share transactions occur. These new rules apply for the 1982 and subsequent taxation years.

ITA
125(8.1)

Once a corporation's cumulative deduction account reaches $1,000,000, it ceases to be eligible for the small business deduction. To prevent eligibility for the small business deduction from being renewed through certain non-arm's length transfers of businesses or share transactions, subsection 125(8.1) of the Act requires additions in computing the cumulative deduction account of certain corporations. These rules apply to transactions after December 1, 1982.

Paragraph 125(8.1)(a) and (d) deal with the situation where a business has been transferred, either directly or indirectly, by a corporation to a person with whom it did not deal at arm's length and a result of the transfer is that the amount of small business deduction that may be claimed with respect to income derived from that business is or may be increased. This could occur when a business is transferred to a new corporation that is not associated with, but does not deal at arm's length with, the transferor. The new provisions require that the portion of the transferor's cumulative deduction account reasonably attributable to income derived from the transferred business be added to the cumulative deduction account of the transferee corporation.

Paragraphs 125(8.1)(b) and (e) of the Act deal with the situation where shares of the capital stock of a particular corporation have been disposed of by a shareholder or issued by the corporation and a result is that the total amount of small business deduction that may be claimed by any corporation with respect to income derived from any business is or may be increased. Where a result of such a share transaction is that the particular corporation ceases to be associated, but continues not to deal at arm's length, with another corporation, the amount of the cumulative deduction account of the particular corporation must be added to the cumulative deduction account or any one other corporation with which it was previously associated.

Paragraphs 125(8.1)(c) and (f) of the Act deal with the situation where one or more shares of the capital stock of a particular corporation have been redeemed, acquired or cancelled by it and a result is that the total amount of small business deduction that may be claimed by any corporation with respect to income derived from any business is or may be increased. Where a result of such a transaction is that the particular corporation ceases to be associated with another corporation but continues not to deal at arm's length with it, the amount of the particular corporation's cumulative deduction account must be added to the cumulative deduction account of any one other corporation with which it was previously associated.

Paragraph 125(8.1)(g) of the Act ensures that an amount added by virtue of paragraphs 125(8.1)(e), (f) or (g) in computing the cumulative deduction account of a corporation that was a member of a group of associated corporations, remains with the group if the corporation ceases to be associated with the group by virtue of a share transaction to which subsection 125(8.1) of the Act does not apply.

ITA 125(8.2)

Subsection 125(8.2) of the Act contains a number of anti-avoidance rules. Paragraph 125(8.2)(a) applies where, after December 1, 1982, there is a non-arm's length transfer of a business from one corporation (the transferor) to another corporation (the transferee) in respect of which the rules in subsection 125(8.1) of the Act did not apply, followed by a share transaction involving shares of the transferee corporation in respect of which that subsection applies. In these circumstances, the rules contained in paragraph 125(8.1)(d) will apply to the transfer of the business to the transferee corporation.

Paragraph 125(8.2)(b) of the Act applies where, after December 1, 1982, there is a non-arm's length transfer of a business from one corporation (the transferor) to another corporation (the transferee) in respect of which subsection 125(8.1) of the Act did not apply, followed by a share transaction involving the shares of the transferor in respect of which that subsection did not apply, and a result of the share transaction is that the transferor will cease to be associated with the transferee. In these circumstances, the rules contained in paragraph 125(8.1)(d) of the Act will apply to the transfer of the business.

Paragraph 125(8.2)(c) of the Act details the circumstances in which two corporations will be considered not to have dealt at arm's length at the time of a business transfer or of a share transaction for the purpose of the rules in subsection 125(8.1), even though one of the corporations was not in existence at that time.

Paragraph 125(8.2)(d) of the Act treats certain persons as not dealing at arm's length where it may reasonably be considered that one of the principal purposes of one or more transactions or events or series of transactions or events was to cause persons to deal at arm's length in order to circumvent the rules in subsection 125(8.1).

ITA 125(8.3)

Subsection 125(8.3) of the Act expands on the circumstances in which a business will be considered to have been transferred for the purposes of the rules in subsection 125(8.1). Where, after December 1, 1982, a corporation ceases to carry on a business and a corporation with which it did not deal at arm's length commences to carry on that business, the business will be considered to have been transferred at the time that the other corporation commences to carry on that business.

ITA 125(8.4)

Subsection 125(8.4) of the Act provides rules for calculating the cumulative deduction account of a corporation where there is an arm's length transfer of property as part of a "butterfly" reorganization described in paragraph 55(3)(b) of the Act that commenced after December 1, 1982. Where such a transfer has taken place, the transferee corporation must add to its cumulative deduction account a pro rata share of the cumulative deduction account of the transferor corporation. The subsection requires that for this purpose the cumulative deduction account of the transferor corporation includes income earned up to the end of its taxation year in which the transfer took place.

ITA 125(8.5)

Subsection 125(8.5) of the Act provides a reduction in the cumulative deduction account of a member of a group of associated corporations where a corporation that owns a business previously transferred out of the group rejoins the group. If the particular corporation that had an amount added to its cumulative deduction account in respect of a business transfer described in paragraphs 125(8.1)(a) and (d) subsequently becomes associated with the corporation that transferred the business, the cumulative deduction account of the transferor corporation is reduced by the lesser of the amount previously added to the particular corporation's cumulative deduction account and the particular corporation's remaining balance in its cumulative deduction account.

ITA 125(8.6)

Subsection 125(8.6) of the Act provides special rules for the purpose of computing the cumulative deduction account of a corporation or members of a group of associated corporations where the rules contained in paragraphs 125(8.1)(b) and (e), (c) and (f), or (g) of the Act previously applied. When a transferred corporation referred to in paragraph 125(8.1)(b), a redeeming corporation referred to in paragraph 125(8.1)(c) or a former associated corporation referred to in paragraph 125(8.1)(g) rejoins a group of associated corporations or becomes associated with a corporation, the corporation that was previously required to add an amount to its cumulative deduction account will obtain a deduction in its cumulative deduction account. The amount of the deduction is set at the lesser of the previous addition or the balance remaining in the cumulative deduction account of the corporation.

Subclause 86(14)

ITA 125(9)(a)

The expression "business connected" is used in the definition of non-qualifying business. A business is connected with a corporation if the business is carried on by a person or partnership where more than 20% of the shares of any class of the corporation are owned by the person, the partners or certain other persons. Paragraph 125(9)(a) defines a "business connected" and is amended to ensure that shares of a corporation owned by a partnership are treated as owned by each member of the partnership in proportion to his interest in the partnership. This amendment applies to taxation years commencing after November 12, 1981.

Subclause 86(15)

ITA 125(9)(c)

Paragraph 125(9)(c) defines a "specified shareholder" of a corporation. This expression is used in a number of provisions of the Act including the definition of non-qualifying business. There are several changes to the definition of specified shareholder. First, a specified shareholder of a corporation now includes a taxpayer who owns at least 10% of the issued shares of any class of any other corporation that is related to the corporation. Previously, a taxpayer was a specified shareholder of a corporation only if he owned 10% or more of the shares of any class of the corporation. Second, shares of a corporation owned by a partnership are treated as being owned by each member of the partnership in proportion to his interest in the partnership. Third, an individual will be considered to be a "specified shareholder" where he performs services on behalf of the corporation, is entitled to not less than

10% of the assets or shares of the corporation or a related corporation and the corporation would be carrying on a "personal services business" if the individual was a specified shareholder of the corporation. These amendments apply to taxation years commencing after November 12, 1981.

Subclause 86(16)

ITA 125(12)

Subsection 125(12) of the Act defined "specified addition to the cumulative deduction account" and "specified reduction to the cumulative deduction account". These definitions are repealed effective for taxation years ending after 1982 since they will no longer be required by virtue of the amendments to subparagraphs 125(6)(b)(iii.1) and (iv.1) of the Act.

Subclauses 86(17) to (22)

These are the effective dates for the amendments to section 125 of the Act.

Manufacturing and Processing Tax Credit

ITA
125.1(3)(b)(vi)
and (vi.1)

Clause 87

Section 125.1 of the Act provides a reduced rate of corporate tax for Canadian manufacturing and processing profits. The rate reduction is provided by allowing a credit of 6% (or 5% in the case of eligible small business profits) of such profits against the federal corporate tax otherwise payable. Thus, for corporations the federal tax on Canadian manufacturing and processing profits is reduced to 30%—10% in the case of a corporation eligible for the small business deduction. Paragraph 125.1(3)(b) excludes certain activities from manufacturing or processing. The amendments to this paragraph provide that the processing of iron ore beyond the pellet stage or its equivalent will be regarded as a manufacturing and processing activity. Previously, the processing of iron ore to the pig iron stage or its equivalent was considered for tax purposes to be a resource activity rather than a manufacturing and processing activity. A consequential amendment will be made in Part XII of the Income Tax Regulations to exclude the processing of iron ore beyond the pellet stage from the definition of "resource profits". This amendment applies to taxation years commencing after November 12, 1981.

Foreign Tax Credit

Clause 88

Subclauses 88 (1) and (2)

ITA
126(1)(b)(i) and (ii)

Section 126 of the Act permits a taxpayer to claim a foreign tax credit. Subsection 126(1) sets out the rules for claiming the credit in respect of non-business-income tax—that is, generally, the foreign taxes imposed on investment income and other categories of foreign source non-business income. The credit cannot exceed the Canadian tax otherwise payable in respect of the foreign source income.

The Canadian tax otherwise payable on the foreign source income is determined by reference to the ratio of foreign source income to total income. The amendments to paragraph 126(1)(b) affect that ratio. Because of the amendments to paragraphs 81(1)(a) and 110(1)(f) of the Act, a consequential amendment is needed to paragraph 126(1)(b)(i) so that in the calculation of foreign source income for the purposes of the ratio, the income of an individual that is exempt from Canadian tax by virtue of a tax treaty continues to be excluded. Subparagraph 126(1)(b)(ii) is also amended so that, for the purposes of the ratio, the total income excludes amounts that are not taxable by virtue of paragraph 110(1)(f). That paragraph applies only to individuals and refers to amounts exempt under a tax treaty, workmen's compensation payments and social assistance payments. These amendments apply to the 1982 and subsequent taxation years.

Subclauses 88(3) and (4)

ITA
126(7)(a) and (c)

In some countries, a portion of the non-resident withholding tax on certain categories of income paid to non-residents is refunded to the foreign payor. The effect of the amendments to subsection 126(7) is to treat this refundable element of foreign taxes as a deductible expense rather than as foreign income that qualifies for credit. This is accomplished by amending the definitions of "business-income tax" in paragraph 126(7)(a) and of "non-business-income tax" in paragraph 126(7)(c) to exclude any tax paid by a resident of Canada to a foreign government that is repaid to any other person. Although such repaid taxes will thereby not be allowed as a tax credit, they will be deductible as an expense under subsection 20(12) of the Act. These amendments apply to taxation years commencing after November 12, 1981. 1981.

Subclause 88(5)

ITA
126(7)(i) to (iii)

Paragraph 126(7)(d) of the Act defines the Canadian tax otherwise payable for purposes of the formulae for determining the foreign tax credit. Subparagraphs (i) to (iii) are amended as a result of the new forward averaging rules in sections 110.4 and 120.1 of the Act to exclude from tax otherwise payable any tax adjustments arising from the application of the new forward averaging rules. This amendment applies to the 1982 and subsequent taxation years.

Subclauses 88(6) and (7)

These set out the effective dates of the amendments to section 126 of the Act.

Clause 89

Subclause 89(1)

ITA 127(7) and (8)

Subsections 127(7) and (8) of the Act provide rules for allocating the investment tax credit of a trust or partnership to its beneficiaries or partners, as the case may be. The amendments to these subsections overcome a technical deficiency which prevented the special 50% investment tax credit in respect of certified property acquired after October 28, 1980 for use in a designated area from being allocated to beneficiaries of a trust or the members of a partnership. These amendments apply to property acquired on or after October 29, 1980—the date on which the special 50% investment tax credit first applied.

Subclause 89(2)

ITA 127(10)(c)

Subsection 127(10) of the Act defines "qualified property" for purposes of the investment tax credit. The amendments to paragraph 127(10)(c) are strictly consequential on the amendment relating to the treatment of iron ore processing in paragraph 125.1(3)(b) of the Act. This amendment applies to taxation years commencing after November 12, 1981.

Subclause 89(3)

ITA 127(12) and (12.1)

The amendments to subsection 127(12) and the introduction of subsection 127(12.1) ensure that the appropriate tax treatment occurs at the partnership or trust level where investment tax credits have been flowed through to members of the partnership or beneficiaries of the trust, as the case may be.

Under paragraph 37(1)(e) of the Act, the deduction allowed for scientific research expenditures of a current nature is reduced by the amount of any investment tax credit deducted by the taxpayer that relates to such expenditures. Similarly, paragraph 13(7.1)(e) reduces the capital cost of depreciable property by the amount of any investment tax credit deducted by the taxpayer that relates to the acquisition of the depreciable property. An anomaly existed, however, where the investment tax credit was not claimed by the trust or partnership that earned the investment tax credit but was flowed through to the members of the parnership or the beneficiaries of the trust.

Subsection 127(12) of the Act ensures that the amount of any investment tax credit allocated to a beneficiary of a trust or a member of a partnership reduces the capital cost of the related depreciable property. Under subsection 127(12.1), the deduction allowed to a trust or partnership for scientific research expenditures must be reduced by the amount of any investment tax credit allocated to a beneficiary of the trust or a member of the partnership, as the case may be, that relates to scientific research expenditures of a current nature. These amendments apply after November 12, 1981.

Subclause 89(4)

ITA 127(17)

Section 127 of the Act sets out the rules for the logging tax credit, the political contributions credit, the investment tax credit and the employment tax credit. New subsection 127(17) is added as a result of the new forward averaging rules in sections 110.4 and 120.1 of the Act and provides that "tax otherwise payable" for purposes of claiming a deduction for the section 127 credits is computed before applying the addition to or deduction from tax under the forward averaging rules. This amendment applies to the 1982 and subsequent taxation years.

Subclauses 89(5) to (8)

These set out the effective dates for the amendments to section 127 of the Act.

Refundable Dividend Tax On Hand

Clause 90

Subclause 90(1)

ITA 129(3)(a)

Paragraph 129(3)(a) of the Act defines the "refundable dividend tax on hand" of a private corporation. This represents the portion of tax on investment income which is refunded to a private corporation on payment by it of dividends.

There are two changes to the calculation of refundable dividend tax on hand. First, the corporation must be a Canadian-controlled private corporation throughout the year in order for its investment income to earn refundable dividend tax in taxation years commencing after November 12, 1981. The refundable dividend tax on hand of all private corporations in respect of taxation years commencing before November 13, 1981 is not affected by this change and will continue to be refundable upon payment of dividends in future years. Second, under new clause 129(3)(a)(i)(B) the amount of refundable dividend tax on hand will be calculated on the net Canadian and foreign investment income. A loss in either category will reduce the investment income in the other category. This change is applicable for taxation years ending after November 12, 1981.

Subclause 90(2)

ITA 129(3.2)

The amendment to paragraph 129(3)(a) of the Act requires a corporation to be a Canadian-controlled private corporation throughout taxation years commencing after November 12, 1981 in order to earn refundable dividend tax on hand. Subsection 129(3.2) is added to the Act as a transitional provision to allow a private corporation, other than a Canadian-controlled private corporation, to include in its refundable dividend tax on hand for such years an amount included in its income in respect of:

(a) property disposed of by it before November 13, 1981;

(b) property disposed of by it pursuant to the terms of an agreement entered into before November 13, 1981; and

(c) property deemed to be disposed of by it after November 12, 1981 under subsection 44(2) of the Act by virtue of its theft, destruction or expropriation before November 13, 1981.

Subclause 90(3)

ITA 129(4)(a)(i)

Subsection 129(4) of the Act defines "Canadian investment income" and "foreign investment income" for purposes of calculating the refundable dividend tax on hand of a corporation. The amendment to subparagraph 129(4)(a)(i) excludes from refundable dividend tax on hand gains or losses on dispositions of property, other than "designated property", that accrued during the period when the property was held by a corporation other than a Canadian-controlled private corporation. The expression "designated property" is defined in new subsection 129(4.3). This amendment applies to dispositions occurring after November 12, 1981 otherwise than pursuant to a written agreement entered into on or before that date.

ITA
129(4)(a)(ii)

The amendment to subparagraph 129(4)(a)(ii) is consequential on the new rule added in paragraph 108(5)(a) of the Act which declares that income from a trust is, except as otherwise provided, to be regarded as income from property. Subparagraph 129(4)(a)(ii) is amended to exclude from the Canadian and foreign investment income of a corporation any business income flowed through a trust that is deemed by paragraph 108(5)(a) to be property income. This amendment will not exclude the investment income of a trust that is distributed to a corporation. This amendment applies to taxation years commencing after November 12, 1981.

Subclause 90(4)

ITA
129(4.3)

Subsection 129(4.3) is added as a transitional provision to define "designated property" for purposes of the changed definitions of Canadian and foreign investment income as discussed in the commentary on paragraph 129(4)(a). For a property of a corporation to qualify as a designated property, the corporation must have been a Canadian-controlled private corporation before November 13, 1981 and the property must have been acquired by it before November 13, 1981 or pursuant to an agreement in writing entered into before that date. Designated property also includes a replacement property for designated property disposed of by virtue of its theft, destruction or expropriation.

Subclauses 90(5) and (6)

These set out the effective dates for the amendments to section 129 of the Act.

Capital Gains Refund to Mutual Fund Trusts

Clause 91

Section 132 of the Act provides for a refund to a mutual fund trust in respect of the tax which it has paid on its capital gains distributed to its unit holders through a redemption of units. This refund mechanism seeks to avoid the double taxation of capital gains that occurs first, when the gain is realized by the trust and second, when its units are redeemed by the investor.

Subclause 91(1)

ITA 132(1)(a)(i)

Subparagraph 132(1)(a)(i) is amended for the 1982 and subsequent taxation years to reduce the rate at which the capital gains refund is calculated to 17% from 17.5%. This amendment is consequential on the reduction in subsection 122(3) of the Act of the rate of tax for mutual fund trusts from 35% to 34%. The rate of 17% recognizes that only one-half of capital gains are included in taxable income.

Subclauses 91(2) and (3)

ITA 132(4)(a)(i)(A) and (b)(i)

The expressions "capital gains redemptions" and "refundable capital gains tax on hand" in relation to a mutual fund trust are defined in subsection 132(4) of the Act. These are calculated in part by reference to the rate of tax for mutual fund trusts. The amendments to these definitions are strictly consequential on the reduction of the tax rate from 35% to 34% for the 1982 and subsequent taxation years.

Subclause 91(4)

This sets out the effective date for the amendments to section 132 of the Act.

Non-Resident-Owned Investment Corporations

ITA
134

Clause 92

Section 134 of the Act provides that a non-resident-owned investment corporation, as defined in paragraph 133(8)(d), is deemed not to be a Canadian corporation or a private corporation except for certain limited purposes—namely, the rules relating to an amalgamation, certain windings-up and the branch tax. The amendment to this section provides a further exception for the purpose of the anti-dividend stripping rules in section 212.1 of the Act. As a result of this amendment, which is applicable after November 12, 1981, section 212.1 of the Act will apply to prevent dividend strips involving non-resident-owned investment corporations.

Cooperative Corporations

Clause 93

ITA 136(1)

Subsection 136(1) of the Act, as amended, provides that, except for the purposes of sections 123.4, 123.5 and 125, a cooperative corporation is deemed not to be a private corporation. The existing subsection 136(1) made an exception only for the purposes of the small business deduction provided in section 125. The amendment is consequential on the addition of sections 123.4 and 123.5 to the Act relating to the corporate surtax. The effect of this amendment is to enable a Canadian-controlled private cooperative corporation to qualify for the special small business exclusion from the base on which the 1982 and 1983 surtax is calculated.

Credit Unions

ITA 137(7)

Clause 94

Subsection 137(7) of the Act, as amended, provides that, except for the purposes of sections 123.4, 123.5 and 125, a credit union is deemed not to be a private corporation. Previously, subsection 137(7) made an exception only for the purposes of the small business deduction provided in section 125. The amendment is consequential on the addition of sections 123.4 and 123.5 to the Act relating to the corporate surtax. The effect of this amendment is to enable a credit union that is a Canadian-controlled private corporation to qualify for the special small business exclusion from the base on which the 1982 and 1983 surtax is calculated.

Deposit Insurance Corporations

Clause 95

ITA 137.1

Section 137.1 of the Act provides special rules for determining the income of a deposit insurance corporation and its member institutions. A deposit insurance corporation includes a corporation incorporated under the *Canada Deposit Insurance Corporation Act* and a corporation formed to provide deposit insurance and other financial assistance to credit unions. A member institution of such a deposit insurance corporation is a credit union qualifying for assistance from, or a corporation whose deposit liabilities are insured by, that deposit insurance corporation.

Subclause 95(1)

ITA 137.1(2)

Subsection 137.1(2) of the existing Act provides that any premiums or assessments received by a deposit insurance corporation from its member institutions are not included in computing its income. The amendment to subsection 137.1(2) of the Act extends this exclusion to premiums and assessments receivable in addition to those actually received by it in the year. This amendment applies for the 1981 and subsequent taxation years.

Subclause 95(2)

ITA 137.1(5)(a)(i)(B)(II)

Paragraph 137.1(5)(a) of the Act defines a "deposit insurance corporation" as a corporation that was either incorporated under the *Canada Deposit Insurance Corporation Act* or that comes within the requirements set out in subparagraph 137.1(5)(a)(i). One of the requirements under this subparagraph is that at least half of its total property must be in the form of specified investments. The amendment to subclause 137.1(5)(a)(i)(B)(II) excludes from the total property, for the purpose of this requirement, any debt obligation issed by a member institution when it was in financial difficulty. This amendment is effective for the 1981 and subsequent taxation years and it ensures that the making of loans to member institutions in financial difficulty will not prevent the required 50% investment ratio from being met.

Subclause 95(3)

This sets out the effective date for the amendments to section 137.1 of the Act.

Clause 96

Subclause 96 (1)

ITA 138(3)(a)(iii)(B)

Subparagraph 138(3)(a)(iii) of the existing Act permits a deduction to a life insurer in respect of policy dividends paid or payable by it in a year under its participating life insurance policies. However, this deduction is limited to the insurer's income from its Canadian participating life insurance business earned in the year in which the policy dividend was paid or payable. Under subparagraph 138(3)(a)(iv), a life insurer is also permitted a reserve for dividends which become payable in the following year on its participating policies.

As a result of these two provisions, a life insurer would be at a disadvantage to the extent that the total of its policy dividends and reserves is less than the full amount of its Canadian participating life insurance business income. The amendment to clause 138(3)(a)(iii)(B) enables a life insurer to obtain a deduction for dividends out of its accumulated Canadian participating life insurance business income earned after 1968—the year preceding that in which life insurers first became taxable. This amendment is applicable to the 1981 and subsequent taxation years.

Subclause 96 (2)

ITA 138(3)(f)

Life insurance companies first became taxable in 1969 and were required to include in their income any interest on a policy loan received in that year. At that time, no provision was made to exclude the policy loan interest earned before the 1969 taxation year. New subparagraph 138(3)(f)(i) permits such a deduction for the first taxation year of an insurer ending after November 12, 1981.

Since 1978, life insurance companies have been required to report their policy loan interest income on a cash basis. Some corporations recorded this income on an accrual basis to the end of the 1977 taxation year. However, when the transition was made in 1978 to the cash basis, no provision was made to exclude from 1978 income the accrued policy loan interest which had been included in income in previous years. New subparagraph 138(3)(f)(ii) permits a deduction to a life insurer in its first taxation year ending after November 12, 1981 for any policy loan interest income accrued at the end of the 1977 taxation year and included in the income of a subsequent taxation year by virtue of this change to the cash basis.

ITA 138(4)(d)

Paragraph 138(4)(d) of the Act requires a life insurer to include in its income for a taxation year all amounts received in the year as interest on a policy loan. In the November 12, 1981 Budget it was proposed to amend paragraph 138(4)(d) to require the inclusion of such interest on an accrual basis. The proposed amendment will not be made. Instead, it is proposed to amend paragraph 1401(1)(c) of the Income Tax Regulations to require accrued interest on policy loans to be deducted in determining the amount of the reserve in respect of the policy that may be deducted in computing an insurer's income. This change will have an effect similar to the November 12, 1981 proposal without producing an unintended duplication of the amount to be included in an insurer's income.

Subclause 96(3)

ITA
138(5)

Paragraph 138(5)(b) of the Act limits the deductibility of interest expense by certain insurers. This subclause makes several amendments to that paragraph.

An amendment is made to exempt a life insurer resident in Canada that carries on its insurance business only in Canada from the provisions of this paragraph. A further amendment clarifies that the property referred to in subparagraphs (i) and (ii) is the property of the insurer defined in paragraph 138(12)(l) as "property used by it in the year in, or held by it in the year in the course of" carrying on its insurance business in Canada. Subparagraph 138(5)(b)(iii) of the existing Act denies a non-resident general insurer a deduction, in computing its income from carrying on an insurance business in Canada, for interest in respect of deposits received or other amounts held in connection with policies insuring Canadian risks. The amendment to this subparagraph permits such a deduction.

These amendments are applicable to taxation years ending after November 12, 1981, except that the clarification of the expression in paragraph 138(12)(l) is effective for taxation years commencing after November 12, 1981.

ITA
138(5.1)

A life insurer resident in Canada is not subject to tax in respect of its life insurance business carried on outside Canada and is therefore denied any foreign tax credit in respect of its insurance business. Subsection 138(5.1) is added to the Act to ensure that any deduction under subsection 20(12) for foreign tax relating to the insurer's non-Canadian insurance business is similarly denied for taxation years ending after November 12, 1981.

Subclause 96(4)

ITA
138(8)

Subsection 138(8) of the existing Act denies a foreign tax credit to a life insurer resident in Canada. This subsection is amended for taxation years commencing after November 12, 1981 to permit such a life insurer to claim a foreign tax credit on foreign taxes paid in respect of its foreign non-insurance income.

Subclause 96(5)

ITA
138(11.1)(b) and (d)

Subsection 138(11.1) of the Act ensures that the identical property rules for capital properties apply to insurers. This amendment ensures, for taxation years commencing after November 12, 1981, that these rules will only treat properties as identical when they are properties described in paragraph 138(12)(l) of the Act and are used in the same insurance business.

Subclause 96(6)

ITA
138(11.3), (11.4), (11.5)
and (11.6)

Under new subsection 138(11.3) of the Act, change-in-use rules are introduced for life insurers resident in Canada and non-resident insurers that carry on an insurance business in Canada. Under these rules, such insurers will be deemed to have disposed of and reacquired property where there is a change in use of that property . The proceeds of disposition are set at the property's fair market value at the time of the change. This new subsection is applicable to changes in use occurring in taxation years commencing after November 12, 1981. New subsection 138(11.4) of the Act provides that should a deemed disposition under new subsection 138(11.3) result in a loss, the loss will not be deductible until the property is actually disposed of.

New subsections 138(11.5) and (11.6) permit a non-resident insurer that incorporates its Canadian insurance branch to elect to "rollover" qualifying property to the corporation that will carry on the business. Where such an election is made under new subsection 138(11.5), the non-resident insurer may transfer the qualifying property to the Canadian corporation at its cost amount unless an election under subsection 85(1) of the Act is made with respect to the property. New subsections 138(11.5) and (11.6) are applicable to taxation years commencing after November 12, 1981.

Subclause 96(7)

ITA
138(12)

Subsection 138(12) of the Act is amended, applicable after November 12, 1981, to extend the definitions provided in this subsection to other sections of the Act in which the defined terms are used.

Subclause 96(8)

ITA
138(12)(c)

A technical amendment is made to the definition of "Canada security" in paragraph 138(12)(c) of the Act to conform to the wording in paragraph 138(12)(l) of the Act.

Subclauses 96(9) to (13)

These set out the effective dates for the amendments to section 138 of the Act.

Private General Insurance Corporations

Clause 97

ITA 141.1

Section 141.1 of the existing Act provides that, except for purposes of the small business deduction, a non-life insurance corporation is deemed not to be a private corporation. The purpose of this provision is to permit a private general insurance corporation to benefit from the small business tax rate but not to be subject to the provisions of the Act relating to the integration of the shareholder and corporate tax on its capital gains and other investment income. The amendments to this section ensure that a capital loss on the disposition of a debt or share of a private insurance corporation may qualify as a business investment loss. As such, one-half of the loss may be deductible without regard to the limitations in paragraph 3(e) of the Act on the deductibility of allowable capital losses. These amendments are applicable to the 1981 and subsequent taxation years.

Clause 98

Subclauses 98(1) to (3)

ITA 146(1)(c)

Subsection 146(1) of the Act provides a number of definitions relating to registered retirement savings plans ("RRSPs"). Paragraph (c) defines the expression "earned income" which is relevant in determining the maximum deduction in respect of premiums under an RRSP in a year. Subparagraph 146(1)(c)(vii) is amended to add a reference to new paragraph 60(j.1) and is consequential on the new rules therein relating to the rollover of retiring allowances. A reference is also added to paragraph 60(l) of the Act relating to the rollover into an RRSP of an amount received out of another RRSP as a refund of premiums. These amendments ensure that amounts deducted under paragraph 60(j.1) or 60(l) reduce the earned income of the taxpayer for purposes of the 20% limitation on deductible premiums.

This amendment applies to the 1981 and subsequent taxation years except that, in its application to the 1981 and 1982 taxation years, the subparagraph is to be read without the reference to paragraph 60(l).

ITA 146(1)(c.1)

Paragraph 146(1)(c.1) has been added to the Act to define "issuer" in relation to an RRSP. It means the trustee or other person described in the definition of "retirement savings plan" with whom the annuitant has arranged to have his plan. This new definition is provided for the purposes of the amendments relating to RRSP transfers in subsection 146(16) and applies after November 12, 1981.

ITA 146(1)(g)

The amendment to paragraph 146(1)(g) simply corrects the cross-reference in the definition of "qualified investment" to "an annuity described in paragraph (i.1)".

Subclause 98(4)

ITA 146(2)(c.4)

Subsection 146(2) of the Act provides the conditions which must be complied with before a retirement savings plan may be registered. This amendment provides a further condition of registration by adding new paragraph 146(2)(c.4). To be registered, a plan must contain a requirement that no supplementary advantage which is in any way dependent on the existence of the plan may be conferred on the annuitant under the plan or on a person with whom the annuitant does not deal at arm's length. Certain exceptions to this rule are provided for. Under subparagraph (iii), the life insurance advantage provided under certain plans may be continued but in an amount no greater than that which was in effect on December 31, 1981.

This amendment applies after November 12, 1981 and should be read together with new subsection 146(13.1) which ensures that if, at any time after June 30, 1982, any advantage is provided with respect to a pre-existing RRSP, it may be treated as an amended plan to which the rules in subsection 146(12) of the Act apply.

Subclause 98(5)

ITA
146(3)(b)(v)

Subsection 146(3) of the Act provides additional rules relating to the types of retirement savings plans which may qualify for registration. Under paragraph 146(3)(b), a retirement savings plan may provide retirement income in the form of certain types of annuities. For example, a variable annuity which depends upon the value of a specified group of assets is permitted under subparagraph (iii) and an annuity which increases at a rate which reflects inflation as measured by the Consumer Price Index or at a fixed rate not exceeding 4% per annum is permitted under subparagraph (iv). The amendment to paragraph 146(3)(b) adds a new type of annuity under which the payments may increase from time to time in accordance with the rate of return on certain pools of investment assets. This amendment applies with respect to annuities issued after November 12, 1981.

Subclause 98(6)

ITA
146(5)

Subsection 146(5) of the Act provides for the determination of the maximum amount which may be deducted by a taxpayer in respect of contributions to RRSPs under which he is the annuitant. Under the existing rules, the maximum amount which may be so deducted by an individual who is employed and a member of his employer's pension plan is the amount by which the lesser of $3,500 and 20% of his earned income exceeds his contributions for the year to the pension plan. In all other cases the maximum amount which may be deducted is the lesser of $5,500 and 20% of earned income. The amendment to subsection 146(5) restricts the contribution limits for employees who have made or on whose behalf contributions have been made in the year to a deferred profit sharing plan.

The opening words of subsection 146(5) are also amended to add a reference to new paragraph 60(j.1). As explained in the commentary on subsection 146(1), this additional reference is consequential on the change in the tax treatment of retiring allowances.

These amendments apply with respect to contributions made to RRSPs for the 1982 and subsequent taxation years.

Subclause 98(7)

ITA
146(8.2)(a)(i)

Subsection 146(8.2) of the Act provides relief in certain cases where a taxpayer makes an over-contribution to an RRSP. Where a refund of the excess contribution is received by the taxpayer from the plan within a specified time period, he may claim a deduction for all or part of the excess refunded to him. Under subparagraph 146(8.2)(a)(i), certain items which have been transferred by the taxpayer to an RRSP, including retiring allowances, are excluded from the calculation of an over-contribution. The amendment to subparagraph 146(8.2)(a)(i) adds a reference to new paragraph 60(j.1) so that transfers of retiring allowances to an RRSP, to the extent deductible under that paragraph, will not be considered as excess contributions. This amendment applies to the 1981 and subsequent taxation years.

Subclause 98(8)

ITA
146(13.1)

This amendment adds new subsection 146(13.1) to the Act and should be read together with new paragraph 146(2)(c.4). Paragraph 146(2)(c.4) provides that a retirement savings plan may not be registered after November 12, 1981 unless it contains a requirement that, subject to certain specified exceptions, no supplementary advantage which is dependent on the existence of the plan may be conferred on the annuitant or a person with whom he does not deal at arm's length. The purpose of new subsection 146(13.1) is to ensure that all RRSPs in existence after June 30, 1982, regardless of when they were registered, abide by the requirement not to provide supplementary advantages to annuitants. If any such advantage is extended after June 30, 1982, the plan may become an amended plan. As such, the plan will no longer qualify as a registered plan with the consequences provided under subsection 146(12) of the Act.

Subclauses 98(9) and (10)

ITA
146(16)

Subsection 146(16) of the Act provides rules relating to the transfer of the funds in one RRSP to another RRSP, a pension plan or a registered retirement income fund. This subsection is amended to extend the circumstances in which funds may be transferred on a tax-free basis between RRSPs. After 1981 any funds in an individual's RRSP may be transferred without tax consequence to an RRSP of his spouse or former spouse provided the transfer takes place on or after the breakdown of the marriage and the other conditions in subparagraph 146(16)(a)(ii) are satisfied. This amendment is applicable to the 1982 and subsequent taxation years.

Subclauses 98(11) to (16)

These set out the effective dates for the amendments to section 146 of the Act.

Registered Home Ownership Savings Plans

Clause 99

Subclause 99(1)

ITA 146.2(2)(h.1)

Section 146.2 of the Act sets out the rules relating to registered home ownership savings plans ("RHOSPs"). Subsection 146(2) provides the conditions for the registration of a RHOSP. The amendment to this subsection is similar to that in paragraph 146(2)(c.4) relating to RRSPs. New paragraph 146.2(2)(h.1) provides generally that, to be registered, a home ownership savings plan must contain a requirement that no supplementary advantage that is in any way dependent on the existence of the plan may be conferred on the beneficiary or a person with whom he was not dealing at arm's length.

This amendment applies after November 12, 1981 and should be read together with new subsection 146.2(7.1) which ensures that the prohibition under paragraph 146.2(2)(h.1) of supplementary benefits applies after June 30, 1982 to all plans, whether registered before or after November 12, 1981.

Subclause 99(2)

ITA 146.2(7.1) and (8)

Subsection 146.2(7) of the Act provides for the revocation of the registration of a home ownership savings plan. New subsection 146.2(7.1) extends the circumstances in which registration may be revoked. New subsection 146.2(7.1) should be read together with paragraph 146.2(2)(h.1) which provides that a home ownership savings plan may not be registered after November 12, 1981 unless it contains a requirement that, subject to certain specified exceptions, no supplementary benefit or loan that is dependent on the existence of the plan may be conferred on a beneficiary thereof or a person with whom he does not deal at arm's length. The purpose of subsection 146.2(7.1) is to ensure that the prohibition under paragraph 146.2(2)(h.1) against supplementary benefits applies not only to plans registered after November 12, 1981 but also to all plans in existence after June 30, 1982, regardless of when registration took place. If at any time after June 30, 1982 any such supplementary benefit is extended, the registration of the plan may be revoked. On revocation, the beneficiary is required under subsection 146.2(8) of the Act to include in his income an amount equal to the fair market value of the property in the plan.

Subsection 146.2(8) of the Act is also amended to add a reference to new subsection 146.2(7.1).

Subclause 99(3)

This sets out the effective date for the amendments to section 146.2.

Registered Retirement Income Funds

Clause 100

Subclause 100(1)

ITA
146.3(1)(f)(i)

Section 146.3 of the Act provides the rules relating to registered retirement income funds ("RRIFs"). The definition of retirement income fund is provided by paragraph 146.3(1)(f). The amendment to this paragraph relates to the payout requirements under such a fund. The existing rules provide a single formula for determining the amount of the annual annuity under the fund. For any year, the amount paid must equal the proportion of the value of the fund at the beginning of the year that one is of the number of years remaining before the annuitant or his spouse would reach age 90. This formula generally results in increasing payments over the term of the RRIF. The amendment allows more flexibility in determining the annual payments under a RRIF for the 1982 and subsequent years. Under paragraph 146.3(1)(f), as amended, the amount paid annually is determined as the amount that would be made under an annuity contract, having a term equal to the difference between 90 and the age of the annuitant, purchased for an amount equal to the value of the fund at the beginning of the year and which yields a return to the annuitant at whatever rate he selects that is not more than 6%. The annual payment may be recalculated each year based on the value of the fund at the beginning of the year, the annuitant's age, and the rate of return he selects for the year.

Subclause 100(2)

ITA
146.3(2)(f.1)

Subsection 146.3(2) of the Act sets out the conditions which must be satisfied in order for a retirement income fund to be registered. This amendment adds a new condition of registration similar to that in paragraph 146(2)(c.4) relating to RRSPs. To be registered, a retirement income fund must contain a requirement that no supplementary benefit or loan that is in any way dependent on the existence of the fund may be conferred on the annuitant or on any person with whom he does not deal at arm's length. Exceptions to this rule are provided for. This amendment applies after November 12, 1981 and should be read together with new subsection 146.3(11.1) which ensures that the prohibition of supplementary benefits under paragraph 146.3(2)(f.1) applies after June 30, 1982 to any registered retirement income fund, regardless of when registration took place.

Subclause 100(3)

ITA
146.3(11.1) and (12)

Subsection 146.3(11) provides for the revocation of the registration of a RRIF. New subsection 146.3(11.1) extends the circumstances in which registration may be revoked. Subsection 146.3(11.1) should be read together with new paragraph 146.3(2)(f.1) which provides that a retirement income fund may not be registered after November 12, 1981 unless it contains a requirement that, subject to certain specified exceptions, no supplementary benefit or loan that is dependent on the existence of the plan may be conferred on the annuitant or a person with whom he does not deal at arm's length. The purpose of subsection 146.3(11.1) is to ensure that the prohibition under paragraph 146.3(2)(f.1) against supplementary benefits applies, not only to plans registered after November 12, 1981, but also to all plans in existence after June 30, 1982, regardless of when registration took place. If, at any time after June 30, 1982, any such supplementary benefit is extended, the registration of the RRIF may be revoked.

On revocation, the annuitant is required under subsection 146.3(12) of the Act to include in his income an amount equal to the fair market value of the property in the fund.

Subsection 146.3(12) of the Act is amended to include a reference to new subsection (11.1).

Subclauses 100(4) and 100(5)

These set out the effective dates for the amendments to section 146.3.

Deferred Profit Sharing Plans

Clause 101

Subclause 101(1)

ITA 147(2)(k.1) and (k.2)

Section 147 of the Act provides the rules relating to deferred profit sharing plans ("DPSPs"). Subsection 147(2) provides the conditions of registration of DPSPs. This amendment, which adds new paragraphs 147(2)(k.1) and (k.2), provides two new conditions which must be satisfied in order for a DPSP to be registered. Paragraph 147(2)(k.1) provides that a DPSP must contain a requirement that no supplementary benefit or loan which is in any way dependent on the existence of the plan may be conferred on the beneficiary under the plan or a person with whom he was not dealing at arm's length. This change is similar to the corresponding changes relating to the registration of RRSPs and other deferred income plans. This amendment should be read together with new subsection 147(14.1) which ensures that the prohibition under paragraph 147(2)(k.1) of supplementary benefits applies after June 30, 1982 to all DPSPs, whether registered before or after November 12, 1981.

New paragraph 147(2)(k.2) requires, as a condition for registration after November 12, 1981, that a DPSP contain a provision prohibiting persons related to the employer and other specified persons from becoming beneficiaries under the plan.

Subclause 101(2)

ITA 147(8)(b)

Subsection 147(8) of the Act provides for the deduction by an employer, within specified limits, of amounts contributed by him on behalf of his employees to a DPSP. The maximum deduction in respect of a particular employee is limited to the least of three amounts: the amount actually contributed by the employer in respect of the employee (paragraph 147(8)(a)); $3,500 minus the amount that the employer is required to contribute in respect of the employee to a registered pension plan (paragraph 147(8)(b)); and 20% of the employee's salary for the year (paragraph 147(8)(c)). The amendment to paragraph 147(8)(b) provides that, for taxation years commencing after November 12, 1981, the $3,500 limitation must be reduced, not only by contributions to a pension plan made in respect of an employee by the employer, but also by such contributions required to be made by any person related to the employer.

Subclauses 101(3) and (4)

ITA 147(9.1) and (10.3)

These amendments, which add new subsections 147(9.1) and (10.3) to the Act, should be read together with new paragraph 147(2)(k.2). Under paragraph 147(2)(k.2), a DPSP registered after November 12, 1981 must contain a provision prohibiting persons related to the employer and certain other specified persons from becoming beneficiaries under the plan. In the case of a DPSP registered on or before November 12, 1981, such persons may continue to be beneficiaries. As a result of new subsection 147(9.1), however, no deduction may be claimed by the employer in respect of contributions made to the plan on their behalf. In addition, under new subsection 147(10.3), such a beneficiary will be required to include in income any contributions made by the employer after December 1, 1982 and any forfeited amounts, that have been allocated to him in the year. These amendments apply with respect to taxation years commencing after 1981.

Subclause 101(5)

ITA
147(14.1)

Subsection 147(14) of the Act provides for the revocation, in specified circumstances, of the registration of a DPSP. New subsection 147(14.1) extends the circumstances in which registration may be revoked and should be read with new paragraph 147(2)(k.1) which provides that a profit sharing plan may not be registered after November 12, 1981 unless it contains a requirement that, subject to specified exceptions, no supplementary benefit which is dependent on the existence of the plan may be conferred on a beneficiary thereof or a person with whom he does not deal at arm's length. The purpose of new paragraph 147(14.1) is to ensure that all DPSPs in existence after June 30, 1982, regardless of when they were registered, abide by this requirement. If any such benefit is extended after that date, the registration of the plan may be revoked. On revocation, the rules provided in subsection 147(15) of the Act apply.

Subclauses 101(6) to (8)

These set out the effective dates for the amendments to section 147.

Clause 102

Section 148 of the Act sets out the rules governing the tax treatment on the disposition of life insurance policies and annuities. The amendments to this section are designed to ensure that the investment income accumulated on annuities and life insurance policies is recognized for tax purposes on a variety of dispositions and deemed dispositions. Certain important expressions used in these sections such as "accumulating fund" and "exempt policy" are to be defined in Part III of the Income Tax Reguations. Draft Part III Regulations are being made available to assist in an understanding of these new rules.

Subclause 102(1)

ITA 148(1)

Subsection 148(1) of the Act requires the inclusion in income of the amount by which the proceeds on the disposition of a life insurance policy, or life annuity, exceed its adjusted cost basis. The subsection has been amended to extend its application to term-certain annuities. Section 39 of the Act no longer provides capital gains treatment on the disposition of term-certain annuities. A further amendment to subsection 148(1) provides an exclusion for annuities whose cost is deductible under paragraph 60(l) of the Act. The proceeds of disposition of such annuities are brought into income by virtue of new paragraph 56(1)(d.2) of the Act. These amendments are applicable to dispositions of annuities after November 12, 1981.

Subclause 102(2)

ITA 148(2)

Subsection 148(2) of the Act sets out the circumstances in which an insurance policy or an annuity is considered to have been disposed of. There are several changes to this section. The existing rule relating to policy dividends is incorporated in paragraph 148(2)(a).

New paragraph 148(2)(b) applies to deem the owner of an annuity contract (other than a life annuity entered into before November 13, 1981) or a life insurance policy acquired after December 1, 1982 to have disposed of it on his death or on the death of the annuitant or the person whose life is insured. For this purpose, the proceeds of the disposition consist of the accumulating fund determined at the relevant time referred to in subparagraph 148(9)(e.2)(iv) of the Act. The proceeds received on a life annuity contract entered into after November 16, 1978 and before November 13, 1981 will continue to be treated in the same manner as under the existing rules.

New paragraph 148(2)(c) applies with respect to an annuity contract or life insurance policy to which the rules in paragraph (b) apply. It treats the holder immediately after the death as having acquired the contract or policy at a cost equal to its accumulating fund at that time. Thus, the adjusted cost basis to the new owner of a life insurance policy will reflect any insurance element in the fund. The meaning of the expression "accumulating fund" is to be provided in section 308 of the Income Tax Regulations.

New paragraph 148(2)(d) considers a disposition to have occurred when a life insurance policy ceases to be an exempt policy. This will occur, for example, when a policy which has been exempt is converted into a annuity contract. The proceeds of disposition of the policy will be equal to its accumulating fund. The meaning of the expression "exempt policy" is to be provided in section 307 of the Income Tax Regulations.

Subclause 102(3)

ITA 148(4)

New subsection 148(4) of the Act provides that, where there is a part disposition of a life insurance policy acquired after December 1, 1982 or an annuity contract, only the proportion of the adjusted cost basis attributable to the part disposed of will be deductible under subsection 148(1) in determining the income resulting from the disposition. The proportion of the adjusted cost basis of a policy that may be so deducted on a partial disposition is the ratio of the proceeds to its accumulating fund. Important exceptions to this are provided for policy dividends and loans so that the rule applies only to other transactions that constitute partial dispositions. This amendment is effective for dispositions after November 12, 1981.

Subclause 102(4)

ITA 148(6)

Subsection 148(6) of the existing Act provides a tax-free "rollover" on the conversion of a life insurance policy into an annuity contract. The amendment restricts this rollover to policies acquired by the taxpayer before December 2, 1982. As a result, where a new policy is so converted in a transaction that constitutes a disposition, subsection 148(1) will apply to require an income inclusion to the extent that the proceeds exceed the adjusted cost basis of the policy. This amendment applies to conversions of policies after December 1, 1982.

Subclause 102(5)

ITA 148(7)

Subsection 148(7) of the Act provides that on certain dispositions, including gifts and non-arm's length dispositions of a life insurance policy or life annuity contract, the policy holder will be considered to have received proceeds equal to its fair market value. This subsection is amended to ensure that the new disposition rule in paragraph 148(2)(b) of the Act takes precedence where the disposition is one to which that paragraph applies. The rule in subsection 148(7) is also being made applicable to dispositions of term-certain annuities. These amendments are effective for dispositions occurring after November 12, 1981.

Subclause 102(6)

ITA 148(9)

This subclause amends the preamble to subsection 148(9) of the Act, applicable after November 12, 1981, so as to make the various definitions contained in that subsection, such as adjusted cost basis and cash surrender value, applicable for purposes of the accrual rules under new section 12.2

and the new rule affecting annuity payments under paragraph 56(1)(d.1) of the Act.

Subclauses 102(7) to (9)

ITA
148(9)(a)

Paragraph 148(9)(a) of the Act contains the definition of adjusted cost basis for annuities and life insurance policies. Subparagraph 148(9)(a)(iii) is amended, effective after November 1, 1981, to increase the adjusted cost basis for amounts included in taxable income as a consequence of the amendment in section 115 that requires non-residents to pay tax on dispositions of certain policies and annuities as described in paragraph 138(12)(g) of the Act.

Subparagraph 148(9)(a)(iii.1) is also amended, effective after November 12, 1981, to increase the adjusted cost basis for amounts subject to tax pursuant to the new provisions which apply with respect to income accrued or paid on a life insurance policy or annuity contract.

New subparagraph 148(9)(a)(v.1) applies with respect to a life annuity to increase its adjusted cost basis for the mortality gain each year. The mortality gain is to be determined in section 309 of the Income Tax Regulations and reflects the increased value that the holder of a life annuity acquires when the annuitants under other life annuities with the same issuer die. This subparagraph is effective for taxation years commencing after 1982.

New subparagraph 148(9)(a)(ix) decreases the adjusted cost basis of a life insurance policy acquired after December 1, 1982 by the pure insurance element of the cost for taxation years commencing after May 31, 1985. This element of cost is to be determined under section 309 of the Income Tax Regulations.

New subparagraph 148(9)(a)(x) decreases the adjusted cost basis of annuity contracts subject to the accrual rules by the amount of annuity payments received. This is necessary because the accumulating fund, which must be compared to the adjusted cost basis in computing income, is reduced by annuity payments. This subparagraph is effective for taxation years commencing after 1982.

New subparagraph 148(9)(a)(xi) applies with respect to a life annuity to decrease its adjusted cost basis for the mortality loss each year. The mortality loss is to be determined in section 309 of the Income Tax Regulations and reflects the decrease in value of a life annuity that occurs when an annuitant under the policy dies. This subparagraph is effective for taxation years commencing after 1982.

Subclause 102(10)

ITA 148(9)(b)

The definition of cash surrender value in paragraph 148(9)(b) of the Act is amended, effective after 1971, to make it clear that policy loans are not to be deducted in computing cash surrender value. This is necessary since, in determining proceeds of disposition in paragraph 148(9)(e.2) of the Act, there is already provision for a deduction for loans.

Subclauses 102(11) and (12)

ITA 148(9)(c)

Paragraph 148(9)(c) of the Act provides the definition of "disposition" for purposes of life insurance policies and annuities.

Subparagraph 148(9)(c)(iv.1) is amended to limit its scope to payments on death under life annuities entered into before November 13, 1981. Life annuities entered into after November 12, 1981 are now dealt with under paragraph 148(2)(b) of the Act.

Subparagraph 148(9)(c)(vii) is repealed and replaced, effective for dispositions after November 12, 1981, by new subparagraphs 148(9)(c)(vii) and (ix). These new subparagraphs exclude from the meaning of disposition any payments received as a disability benefit, as an accidental death benefit or on death under either a life insurance policy acquired before December 2, 1982 or an exempt policy. Thus, a payment on death under a non-exempt life insurance policy acquired after December 1, 1982 will be a disposition.

Subparagraph 148(9)(c)(viii) is amended, effective for dispositions after November 12, 1981, as a consequence of the amendments that bring term-certain annuities within the scope of section 148.

Subclause 102(13)

ITA 148(9)(e.1)

The definition of premium in paragraph 148(9) (e.1) of the Act is amended, effective after November 12, 1981, to ensure that prepaid non-refundable premiums under a policy are included in its adjusted cost basis and to exclude from the meaning of premium that portion of any costs incurred after May 31, 1985 that relate to accidental death and disability benefits and to certain additional risks.

Subclause 102(14)

ITA 148(9)(e.2)(iv)

New subparagraph 148(9)(e.2)(iv) of the Act defines proceeds of disposition, for purposes of paragraph 148(2)(b), as the accumulating fund immediately before death for a life insurance policy and immediately after death for an annuity contract. The purpose of this amendment is to ensure that the deceased is not taxed on the insurance element of a life insurance policy and to reduce proceeds by the amount of any decrease in value of an annuity that occurs as a consequence of death. This subparagraph is effective for dispositions occuring after December 1, 1982.

Subclause 102(15)

ITA 148(10)

The amendment to paragraph 148(10)(a) of the Act is consequential on the extension of the scope of section 148 to term-certain annuities. New paragraph 148(10)(c) has been added to treat a life insurance policy held continuously since its issue as having been acquired on the later of the day the policy came into force and the day the application therefor was filed. Both changes are effective after November 12, 1981.

Subclauses 102(16) to (21)

These set out the effective dates for the amendments to section 148.

Exemptions From Tax

Clause 103

Subclauses 103(1) and (2)

ITA 149(1)(o.2)

Paragraph 149(1)(o.2) of the Act exempts from tax certain types of corporations involved with pension fund administration and investments if all of the shares and rights to acquire shares of the corporation are owned by, or in certain cases held exclusively for the benefit of, one or more registered pension plans. Subparagraph 149(1)(o.2)(ii.1) is added to the Act to extend the types of corporations which may qualify for exempt status. For taxation years commencing after 1978, a corporation wholly owned by pension plans that restricts its investments and activities to the acquisition and development of Canadian resource properties will qualify for exempt status. Subparagraph 149(1)(o.2)(iv) of the Act is also amended for taxation years commencing after 1978 so that a corporation whose shares are held indirectly by a registered pension plan through a trust will qualify for exempt status.

Subclause 103(3)

ITA 149(10) and (11)

This amendment adds new subsections 149(10) and (11) to the Act. Subsection 149(10) provides special rules where a corporation ceases after November 12, 1981 to be exempt from tax so as to ensure that any gain or loss subsequently realized by the corporation when it is taxable does not include any gain or loss which accrued when it was exempt. For this purpose, the corporation is deemed to have disposed, immediately before the time that it ceases to be exempt, of all of its property, other than a resource property, for fair market value, and to have reacquired such property at that value. In the case of depreciable property having a value less than its capital cost, the difference between the fair market value and the capital cost is deemed to have been allowed as capital cost allowance.

Subsection 149(11) provides that new subsection 149(10) does not apply to a corporation that loses its exempt status after November 12, 1981 by reason of a change of control of the corporation pursuant to a written agreement entered into on or before that date.

Subclause 103(4)

This sets out the effective dates for the amendments to section 149 of the Act.

Withholding of Tax

Clause 104

Section 153 of the Act requires every person making any of the payments described in paragraphs 153(1)(a) to (m) to deduct or withhold tax therefrom and to remit the tax on behalf of the recipient to the Receiver General of Canada. The amount of tax to be deducted or withheld is determined in Part I of the Income Tax Regulations.

Subclause 104(1)

ITA 153(1)(a)

Paragraph 153(1)(a) of the Act is amended to authorize prescribed withholding in respect of all amounts paid, after Royal Assent to this Bill, as salary, wages or other remuneration. Before this amendment, withholding was authorized only in respect of such payments as were made to an officer or employee.

Subclause 104(2)

ITA 153(1)(m) and (n)

Paragraph 153(1)(m) of the existing Act requires that tax be withheld from termination payments. Because of the repeal of the definition "termination payment" in subsection 248(1) of the Act, paragraph 153(1)(m) is also repealed and replaced with a new paragraph 153(1)(m) which requires withholding in respect of any amount received after 1981 as a benefit under the *Labour Adjustment Benefits Act.* Benefits under this Act are required to be included in the income of the recipient under paragraph 56(1)(a) of the Act as amended. However, the former paragraph 153(1)(m) will continue to apply to payments made after November 12, 1981 with respect to a termination of an office or employment that occurred before November 13, 1981. Consequently, withholding would be required in such circumstances.

Paragraph 153(1)(n) of the Act, effective after Royal Assent to this Bill, is added to provide that an individual may elect to have any amount paid to him to be subject to withholding tax, notwithstanding that the amount is not specifically enumerated in any of paragraphs 153(1)(a) to (m) of the Act. For example, fishermen may elect to have tax withheld and remitted in respect of amounts paid to them out of proceeds received on the sale of fish.

Subclause 104(3)

ITA 153(2)

Subsection 153(2) of the Act is applicable to individuals in receipt of remuneration from which tax has been deducted or withheld under subsection 153(1). It provides that if the remuneration from which amounts were deducted comprises at least three-quarters of the individual's income for the year, he must pay the remainder of his tax on or before April 30 in the following year. If such remuneration is less than three-quarters of the individual's income, he is required to pay interim quarterly instalments of tax under section 156 of the Act.

Existing subsection 153(2) refers only to remuneration. The amendment, effective after Royal Assent to this Bill, ensures that all of the receipts from which tax has been deducted under subsection 153(1) are to be included in the rule for determining when quarterly instalments are required.

Subclause 104(4)

This sets out the effective dates for the amendments to paragraph 153(1)(m) of the Act.

Payment of Tax—Farmers and Fishermen

Clause 105

ITA 155(1)

Subsection 155(1) of the Act provides special rules for instalment payments of tax by individuals whose chief source of income is farming or fishing. All such individuals are required to remit their first instalment payment on or before December 31. At that time, these taxpayers have the choice of paying two-thirds of either their estimated tax for the year or their "instalment base" as determined under the Income Tax Regulations for the preceding year. The remainder of the tax must be paid on or before April 30 of the following year.

The amendment to subsection 155(2) is effective after Royal Assent to this Bill. It ensures that instalments of tax will not be required by farmers and fishermen who have had tax deducted from payments which amount to at least three-quarters of their income for the year.

Payments of Tax by Corporations

Clause 106

ITA 157(1)(a)(i)

Section 157 of the Act sets out the rules relating to the payment of tax by corporations. Paragraph 157(1)(a) provides the rules relating to corporate tax instalments. The amendment to subparagraph 157(1)(a)(i) provides that the amount of any instalment of corporate tax is to be determined without reference to the special corporate surtax (5% up to December 31, 1982 and 2½% for the 1983 calendar year) imposed under sections 123.3, 123.4 and 123.5 of the Act. As a result, the corporate surtax need not be paid before the date on which the final payment of the regular corporate tax is payable—ordinarily, for corporations subject to the surtax, two months after its taxation year end. This amendment is applicable to taxation years ending after 1981.

Tax on Income from Property Transferred

ITA
160(1)

Clause 107

When property is transferred by a taxpayer to his spouse or to a person under 18 years of age, sections 74 and 75 of the Act provide that any income or loss arising from that property is considered to be that of the transferor and not of the recipient. In such circumstances, subsection 160(1) of the Act provides that the transferor and the transferee are jointly and severally liable for the tax attributable to income arising from the transferred property. The effect of adding the reference to gains from the disposition of property and to section 75.1 of the Act in new paragraph 160(1)(d) is to extend the application of the section to tax payable in respect of any capital gain attributable to the transferor on a subsequent disposition of the property by the transferee.

Subsection 160(1) is also amended to extend joint and several tax liability where property is transferred between persons not dealing at arm's length. The existing provisions in paragraph 160(1)(d) that make the transferor and transferee jointly and severally liable to pay an amount in respect of the transferor's tax liability on the day of the transfer have been amended in new paragraph 160(1)(e) to extend the liability to include amounts payable by the transferor under the Act for the year in which the property was transferred. A further amendment limits the liability of a transferee in respect of amounts payable by the transferor for years up to and including the year of transfer to the amount by which the fair market value of the property at the time of transfer exceeds the fair market value of any consideration given in return.

These amendments apply with respect to transfers of property after November 12, 1981.

Interest on Underpayments of Tax

ITA
161(6.1)

Clause 108

Section 161 of the Act provides for the payment of interest on unpaid tax in accordance with the rates prescribed in section 4300 of the Income Tax Regulations. When a taxpayer has not paid the full amount of his tax payable, interest on the deficiency is required to be paid from the day on which payment should have been made until the date of payment. If a taxpayer were to receive a refund in a year of foreign tax paid in a previous year, this could reduce his foreign tax credit or deduction, thereby increasing his Canadian income tax liability for that previous year. Interest would then be charged on the amount of the increase in Canadian tax from the date on which tax for the previous year was payable. The new subsection 161(6.1) provides that no interest will be payable, in respect of an underpayment of Canadian tax resulting from an adjustment of foreign tax, for the period ending 90 days after the taxpayer is first notified of the foreign tax adjustment. This amendment is applicable with respect to notifications made after 1980.

Corporate Distributions Tax (Part II)

ITA
181, 182

Clause 109

This clause introduces a new tax of 12 ½ % on certain corporate dividends distributed out of income benefitting from the low small business tax rate. This tax is imposed under Part II (sections 181 and 182) of the Act.

The following example illustrates how the tax fits into the general scheme under the Act for taxing distributed corporate earnings. The example assumes that a Canadian-controlled private corporation has $100 of income subject to federal tax of 15 %, the rate on most categories of Canadian active business income, and provincial tax of 10 %.

Corporate income	$100
Income tax	25
Net after-tax earnings	$ 75

For a corporation subject to the 12 ½ % tax on corporate distributions, the maximum amount that could be distributed to shareholders would be $66.67 after taking into account the corporate distributions tax as follows:

Dividend	$66.67
Tax on distribution (12 ½ %)	8.33
Total	$75.00

In these circumstances, an individual shareholder taxable at a combined federal and provincial tax rate of 40 % would be taxable on the dividend as follows:

Dividend received	$ 66.67
Gross-up—50 %	33.33
Dividend income	$100.0
Tax thereon—40 %	$ 40.00
Dividend tax credit	33.33
Net tax	$ 6.67

The total tax payable on the $100 of income would be $40 as follows:

Corporate income tax	$25.00
Corporate distributions tax	8.33
Personal income tax	6.67
	$40.00

This $40 is the same amount of tax that would have been paid on the income if, instead of receiving it through the corporation, the shareholder in the 40% tax bracket earned the $100 of income directly.

This example is simplified in order to illustrate the role of the corporate distributions tax in the context of what is generally referred to as the "integration system" for corporate earnings. The 12 ½% tax on dividends ensures a closer balance between the corporate taxes paid on distributed small business earnings and the dividend tax credit available to shareholders.

ITA
181(1)

Subsection 181(1) of the Act provides that the corporate distributions tax of a corporation for a taxation year is 12 ½% of the amount of taxable dividends paid by the corporation in the year to a maximum of one-ninth of its preferred-earnings amount at the end of the year. The "preferred-earnings amount" of a corporation is defined in subsection 181(2) and means its retained after-tax income, earned in taxation years commencing after 1982, that qualified for the full small business deduction. The limitation of the corporate distributions tax to one-ninth of the preferred-earnings amount ensures that only that income which has benefitted from the small business deduction under subsection 125(1) of the Act will be taxed upon distribution. (In the above example, one-ninth of the after-tax business earnings of $75 equals $8.33. This represents the maximum corporate distributions tax that would be exigible if all the earnings of the corporation were distributed to shareholders.)

Dividends paid out of the earnings of a non-qualifying business will not be subject to the 12 ½% tax. These earnings benefit from a separate small business deduction under subsection 125(1.1) of the Act which generally reduces the effective tax rate to about 33 ⅓% depending on the province in which the income is taxable.

Under subsection 181(1), all corporations, other than those exempt from Part I income tax, are subject to the corporate distributions tax. Thus, where a Canadian-controlled private corporation, which has claimed the small business deduction, becomes a public corporation and subsequently distributes its profits, it will be subject to the tax on its distributions to the extent that it has a balance of preferred-earnings amount at the end of the year of distribution. Capital dividends and life insurance capital dividends are exempt from the corporate distributions tax. In addition, the amount that is treated as a taxable dividend on an arm's length small business development bond is not subject to the tax.

ITA
181(2) and (3)

The "preferred-earnings amount" is determined on a cumulative basis. By virtue of subsection 181(3), the preferred-earnings amount is nil at the end of taxation years commencing before 1983. Thus, this amount is calculated by reference only to the earnings of a corporation from an active business that qualified for the small business deduction in taxation years commencing after 1982. The starting point for calculating the preferred-earnings amount of a corporation at the end of a year under paragraph 181(2)(a) is its accumulated after-tax earnings that qualified for the small business deduction under subsection 125(1) in previous years starting with the first taxation year commencing after 1982. To this amount is added the after-tax active business earnings that qualified for the small business deduction under that subsection in the current year. This is provided in paragraph 181(2)(b) of the Act. The reference therein to three-quarters of the income assumes a corporate tax of 25% on active business income.

The total of the amounts determined under paragraphs 181(2)(a) and (b) is reduced by the amount determined under paragraph 181(2)(c), which consists of two components. The first is the amount distributed in the immediately preceding taxation year out of active business earnings which benefitted from the small business deduction, and the second is the distributions tax paid thereon. The amount determined under paragraph 181(2)(c) may not exceed the balance of the corporation's preferred-earnings amount at the end of the immediately preceding taxation year.

Paragraphs 181(2)(d) and (e) provide for special reductions in determining the preferred-earnings amount of a corporation. Paragraph (d) provides a reduction equal to nine times the amount of tax paid by the corporation for the current year under subsection 181(4). Subsection 181(4) imposes a special tax on an amalgamation or a subsection 88(1) winding-up where the result is to reduce the potential liability for the corporate distributions tax. Nine times this special tax represents the after-tax earnings that qualified for the small business deduction on which the liability for distributions tax had thereby been reduced.

Paragraph 181(2)(e) provides a further reduction equal to three-quarters of the corporation's preferred-rate amount that was taxed under Part VI of the Act in the year. The tax under Part VI applies when a corporation becomes a private corporation controlled by non-residents. The purpose of the tax is to recapture the benefit of the small business deduction on undistributed profits on the change of the corporation's status. Since the small business deduction benefits are recaptured and regular tax rates effectively apply, the distributions tax should not apply to these profits. The deduction under paragraph 181(1)(e) achieves this result by excluding the earnings on which the Part VI tax was paid from the preferred-earnings amount of the corporation.

ITA
181(4)

Subsection 181(4) deals with the case where a corporation's potential liability for the corporate distributions tax is reduced by virtue of an amalgamation or a winding-up. The subsection provides a tax equal to the amount of the reduction of the potential tax liability. This tax is payable by the amalgamated corporation or the parent corporation for its first taxation year ending after the amalgamation or winding-up. This subsection would apply, for example, where the shares of an operating company with a preferred-earnings amount are acquired by a newly-created corporation that issues shares having a high paid-up capital as consideration. Although any balance in the subsidiary's preferred-earnings amount would flow through to the parent on the amalgamation or winding-up by virtue of paragraph 87(2)(y.1) or 88(1)(e.2) of the Act, the higher paid-up capital of the amalgamated or parent corporation would result in the distribution of income that had benefitted from the small business deduction to shareholders as a return of capital rather than as taxable dividends. The imposition of the tax under subsection 181(4) is designed to ensure that an amalgamation or winding-up will not result in the avoidance of corporate distributions tax.

ITA
181(5) and (6)

Subsections 181(5) and (6) provide rules designed to prevent the avoidance of the corporate distributions tax by means of a non-arm's length sale of shares, the payment of a dividend, the making of loans or the incurring of indebtedness. Dividends paid out of the retained earnings of a corporation will not give rise to tax under this subsection. For this purpose, the retained earnings of a corporation will be determined according to generally accepted accounting principles but will not include the retained earnings of another corporation reflected in its surplus or the earnings attributed to a non-arm's length disposition of property otherwise than in the ordinary course of business. In addition, loans or indebtedness for which reasonable repayment arrangements are made or to which subsection 15(2) of the Act applies will not give rise to a liability for tax under this subsection.

Liability for tax under subsection 181(5) will arise only in those circumstances where the amount was received or indebtedness was incurred as part of a transaction or series of transactions effected after November 12, 1981 a main purpose of which was to avoid the corporate distributions tax that might otherwise have become payable by reason of a distribution of property of any particular corporation. The tax under subsection 181(5) is imposed on the particular corporation and is the amount of corporate distributions tax avoided.

ITA
182

Section 182 of the Act sets out the rules relating to the filing of returns, payment of tax and interest on unpaid tax, and various other procedural and administrative matters with respect to the corporate distributions tax.

Sections 181 and 182 apply after November 12, 1981. However, no return is required to be filed and no tax is payable under these sections before 30 days after Royal Assent to this Bill.

Excessive Elections (Part III)

Clause 110

ITA
184

When a corporation makes an election under subsection 83(2) of the Act to treat a dividend as a capital dividend, no part of the dividend is included in the shareholder's income. If the full amount of the dividend exceeds the capital dividend account of the corporation, Part III (sections 184 and 185) of the Act applies. In these circumstances, the corporation must pay what is referred to as an excessive election tax of three-quarters of the excess, unless the corporation and all shareholders who received the dividend agree to make a further election to treat the excess as a taxable dividend. The tax under Part III is set at a rate which ensures that shareholders in the highest marginal rate brackets cannot obtain any advantage through an excessive election. All of the amendments to section 184 of the Act are consequential on the amendments adding subsection 83(2.1) and paragraph 89(1)(b.2) relating to life insurance capital dividends. The rules described above relating to the Part III tax on capital dividends are extended to life insurance capital dividends.

Subclauses 110(1) to (3)

ITA
184(2)

Subsection 184(2) is amended to add a reference to subsection 83(2.1) of the Act. Accordingly, if an election is made under subsection 83(2.1) of the Act to treat a dividend as a life insurance capital dividend and if the full amount of the dividend exceeds the life insurance capital dividend account, the corporation must pay a tax of three-quarters of the excess together with interest from the time of the election to the time of payment.

ITA
184(3)(a) and (b)

The reference to subsection 83(2.1) is also added to paragraphs 184(3)(a) and (b) of the Act. As a result, instead of paying the excessive election tax imposed by subsection 184(2), the corporation, with the concurrence of the recipients of the life insurance capital dividend, may elect in a prescribed manner and within a prescribed time to treat all or part of the excess as a separate taxable dividend.

ITA
184(3)(d)(ii)

Subparagraph 184(3)(d)(ii) of the Act is amended to add a reference to a life insurance capital dividend. Accordingly, when a valid election is made under subsection 184(3) to treat the excess as a separate taxable dividend, each shareholder entitled to receive a share of the actual life insurance capital dividend is deemed by virtue of paragrah 184(3)(d) to have received his proportionate share of the separate taxable dividend.

The amendments to section 184 are effective after Royal Assent to the Bill.

Clause 111

The purpose of the 25% tax imposed under Part IV of the Act on dividends received by a private corporation is to prevent an individual from benefitting from the deferral of tax that would otherwise be possible if, instead of receiving dividends directly, he arranged for his investment in shares to be held by a corporation. Because dividends are generally permitted to pass between corporations on a tax-free basis, the interposition of a corporation would, in the absence of the tax under Part IV, allow dividends on the shareholdings to be received free of tax. Section 186 imposes a special tax of 25%, generally referred to as the Part IV tax, on dividends received by a private corporation. This tax is fully refunded to the corporation upon the payment of taxable dividends to its shareholders.

Subclause 111(1)

ITA
186(1)

Subsection 186(1) of the existing Act is applicable to a corporation which was a private corporation at any time in a taxation year. This subsection has been amended to extend the application of Part IV tax to "subject corporations" for taxation years commencing after November 12, 1981. A "subject corporation" is defined to be a corporation resident in Canada, other than a private corporation, which is controlled directly or indirectly in any manner by or for the benefit of an individual or a related group of individuals. In addition to the usual direct control situations, this provision ensures that an individual or a related group of individuals will be considered to exercise control of a corporation where it is held in an indirect manner, for example, through shareholdings in another corporation, an interest in a partnership or a trust or any combination of these.

Subclause 111(2)

ITA
186(1)(d)

Paragraph 186(1)(d) of the Act permits a private corporation to apply non-capital losses from the immediately preceding taxation year and the five following taxation years against its Part IV tax base so as to reduce the amount of tax payable. Paragraph 186(1)(d) is amended to permit a subject corporation to apply any available non-capital losses to reduce its Part IV tax. This amendment is consequential on the amendment to subsection 186(1) which extends the 25% Part IV tax to subject corporations.

Subclause 111(3)

ITA
186(2)

Subsection 186(2) of the Act provides a special rule for determining when one corporation is controlled by another corporation for the purposes of Part IV. The amendment to subsection 186(2) provides that this special control test does not apply to determine whether or not a corporation is a subject corporation. This amendment is consequential on the amendments to subsection 186(1) of the Act and is applicable to taxation years commencing after November 12, 1981.

Subclause 111(4)

ITA
186(4)(b)

Dividends received from a "connected corporation" are subject to Part IV tax only to the extent that their payment generates a refund of tax under section 129 of the Act to the corporation which paid the dividend or if the recipient of the dividend elects to pay the Part IV tax. Paragraphs 186(4)(a) and (b) of the Act define the circumstances under which a dividend-paying corporation is considered to be "connected" with a recipient corporation.

Paragraph 186(4)(b) of the Act is amended to remove the requirement that a payor corporation be a private corporation. As a result of this amendment, a corporation paying a dividend to another corporation will be connected with that corporation if it owns more than 10% of the issued share capital of that corporation having full voting rights under all circumstances and having a fair market value of more than 10% of the fair market value of all of the issued share capital. The amendment to paragraph 186(4)(b) is applicable to taxation years commencing after November 12, 1981.

Subclause 111(5)

ITA
186(5)

The Part IV tax imposed on a corporation under subsection 186(1) of the Act is refunded by virtue of section 129 on the payment of taxable dividends by the corporation to its shareholders. The addition of subsection 186(5) to the Act is consequential on the extension of the Part IV tax to dividends received by "subject corporations".

Subsection 186(5) deems a "subject corporation" to be a private corporation for the purposes of the flow-through of "refundable dividend tax on hand" on an amalgamation or winding-up and for purposes of the dividend refund in section 129 of the Act. This will permit a subject corporation to receive a dividend refund in respect of Part IV tax previously paid.

Subclause 111(6)

This sets out the effective date for the amendments to section 186.

Corporations Exempt from Part IV Tax

ITA
186.1

Clause 112

Section 186.1 of the existing Act provides an exemption from the payment of Part IV tax for bankrupt corporations. Prescribed venture capital corporations are also exempt. The amendments extend the exemption to prescribed investment contract corporations, insurance corporations and corporations licensed as a trustee. This amendment to section 186.1 of the Act is applicable to taxation years commencing after November 12, 1981, except that with respect to insurance corporations it is applicable to the 1981 and subsequent taxation years.

Tax on Deferred Profit Sharing Plans

Clause 113

While a trust governed by a deferred profit sharing plan ("DPSP") is generally exempt from tax, in certain circumstances the trust may be subject to tax under Part X (sections 198 to 204) of the Act. For example, the Part X tax will apply where a trust governed by a DPSP acquires a "non-qualified investment" or uses any property of the trust as security for a loan. Part X tax is also payable when a beneficiary of such a trust forfeits contributions that were allocated to him, although reallocations to other beneficiaries may reduce the tax.

This Bill repeals the provisions in section 257 of the Act for determining whether a corporation had a degree of Canadian ownership. Several of the definitions previously provided in section 257 remain relevant for the purposes of the Part X tax and, accordingly, they have now been added to the definitions contained in section 204 of the Act.

Subclause 113(1)

ITA
204(a)

The term "equity share" is defined in paragraph 204(a) of the Act. This definition is similar to the definition of equity share in existing paragraph 257(2)(e), except that it now includes a reference to the new term "excluded share" explained below. The definition of equity share is used in determining whether or not a share is a "qualified investment" for the purposes of Part X of the Act.

ITA
204(a.1)

Paragraph 204(a.1) provides the definition of the new term "excluded share". Although this term was not defined as such in section 257, existing paragraph 257(2)(h) deems certain shares not to be equity shares. With the amendments to section 204 and the repeal of section 257, shares which are excluded shares are not considered to be equity shares. An excluded share is a share of a private corporation that, in general terms, is a "non-participating share" with certain dividend entitlements or is part of the capital stock of a corporation where equity shares make up less than 50% of its paid-up capital.

ITA
204(a.2)

Paragraph 204(a.2) defines the term "non-participating share". The definition is identical to that in existing paragraph 257(2)(f).

ITA
204(a.3)

A non-participating share of a corporation that is not a private corporation is any share other than a common share. In the case of a private corporation, a non-participating share is a share with certain dividend entitlements. Paragraph 204(a.3) defines the term "paid-up capital value" of a share. This definition is similar to that provided in existing subparagraph 257(2)(g)(ii). The paid-up capital value of a share is determined by dividing the aggregate paid-up capital of the class to which the share belongs by the number of issued and outstanding shares of that class.

Subclause 113(2)

ITA
204(f)

Paragraph 204(f) defines the term "revoked plan". It has been amended to include a reference to subsection 147(14.1) which sets out an additional basis for revocation of a DPSP.

Subclause 113(3)

This sets out the effective date for the amendments to section 204 of the Act, except for paragraph 204(f) which is effective on Royal Assent to this Bill.

Over-Contributions To Deferred Income Plans

Clause 114

Part X.1 of the Act (sections 204.1 to 204.3) imposes a special tax on over-contributions to deferred income plans.

Subclause 114(1)

ITA
204.2(1)(a)

Subsection 204.1(1) of the Act imposes a special tax when an individual has an "excess amount for a year in respect of registered retirement savings plans" at the end of any month. The tax is equal to 1% of the excess amount for each month that the excess remains in the plans.

The definition of the "excess amount for a year in respect of registered retirement savings plans" is provided in subsection 204.2(1) of the existing Act. In general terms, it is the amount in excess of $5,500 per annum which an individual has contributed to these plans. Excluded from such contributions, however, is any amount "rolled" on a tax-free basis into a plan under paragraph 60(j) (transfer of superannuation benefits and retiring allowances), paragraph 60(l) (transfer of refund of premium under registered retirement savings plan), or subsection 146(16) (transfer of funds to another registered retirement savings plan). As a result of the splitting of paragraph 60(j) of the Act into new paragraphs 60(j) and (j.1) a reference to paragraph 60(j.1) is now included in this definition.

In addition, non-residents are entitled to a tax-free "rollover" on the transfer of certain pension benefits and retiring allowances into a registered retirement savings plan under the amendments to paragraphs 212(1)(h), (j) and (l) of the Act. As amended, paragraph 204.2(1)(a) will also exclude from the calculation of the excess amount any amounts rolled into a registered retirement savings plan under these new provisions.

The amendments to paragraph 204.2(1)(a) are applicable to the 1981 and subsequent taxation years.

Subclause 114(2)

ITA
204.2(4)(a)

Subsection 204.1(3) of the Act imposes a special tax when a trust governed by a deferred profit sharing plan has an excess amount at the end of any month. The tax is equal to 1% of the excess amount for each month that the excess remains in the trust.

The definition of the "excess amount" for a trust governed by a deferred profit sharing plan is provided in subsection 204.2(4). In general terms, it is the amount in excess of $5,500 per annum which an individual has contributed, less any contributions returned to him. This subclause amends subsection 204.2(4) to exclude any contributions to which paragraph 60(k) applies. Paragraph 60(k) provides that the least of the following amounts may be "rolled" on a tax-free basis into a deferred profit sharing plan:

- amounts contributed in the year or within 60 days after the end of the year to a deferred profit sharing plan that had at least five beneficiaries;
- amounts received by a beneficiary out of a deferred profit sharing plan under the provisions of subsection 147(10); and
- superannuation and pension benefits and deferred profit sharing plan income received by the beneficiary minus any amount transferred into a registered retirement savings plan under the provisions of paragraph 60(j).

This amendment, applicable after May 1976, ensures that a tax-free rollover to a deferred profit sharing plan under paragraph 60(k) does not create an over-contribution and thereby cause the Part X.1 tax to apply.

Subclauses 114(3) and (4)

These set out the effective dates for the amendments to section 204.2 of the Act.

Registered Investments

ITA
204.4(4)

Clause 115

A trust or a corporation may apply to become a registered investment for purposes of a registered retirement savings plan, a registered home ownership savings plan, a registered retirement income fund or a deferred profit sharing plan under the provisions of section 204.4.

Part X.2 of the Act (sections 204.4 to 204.7) provides for the payment of a special penalty tax by a trust or corporation that is a registered investment when it holds certain specified property. The amendment to subsection 204.4(4) corrects an anomaly with respect to the payment of the penalty tax. Under the existing legislation, the trust or corporation continues to be liable for the penalty tax after it has ceased to be a registered investment. This amendment will ensure that the tax will cease to be applied when the trust or corporation loses its designation as a registered investment. This amendment is applicable to the 1981 and subsequent taxation years.

Penalty Tax Payable by Registered Investments

ITA
204.6(2)(b)(ii) and (3)

Clause 116

Section 204.6 of the Act provides the manner of calculating the tax payable by a registered investment which holds property at the end of any month which is not a prescribed investment. The amendments to subparagraph 204.6(2)(b)(ii) and subsection 204.6(3) clarify certain time references. The existing wording "at that time" in subparagraph 204.6(2)(b)(ii) and paragraph 204.6(3)(b) of the Act could be incorrectly interpreted to mean the time of acquisition of the property in question. The wording has been altered for the 1981 and subsequent taxation years, to clarify that the time referred to in these provisions is the end of the month to which section 204.6 applies.

Property of Deferred Income Plans

Clause 117

Part XI of the Act (sections 205 to 207) provides that certain deferred income trusts, pension trusts and corporations, registered investments and persons exempt from Part I tax will be subject to a special tax on certain foreign property or certain rights to acquire shares.

Subclause 117(1)

ITA 206(1)

Under subsection 206(1) of the Act, the tax applies where more than 10% of the property held by a pension trust or corporation, deferred income trust or a registered investment consists of foreign property. The existing subsection does not exclude from the calculation of the Part XI tax any foreign property which has already given rise to tax because it was not a "qualified investment". The amendment to subsection 206(1) avoids this potential for double taxation by providing an exclusion for foreign property that is also a non-qualified investment. This amendment is applicable after December 11, 1979.

Subclause 117(2)

ITA 206(1.1)

Subsection 206(1.1) of the Act imposes a penalty tax on a deferred income trust, pension trust or corporation, registered investment or tax-exempt entity which has entered into an agreement to purchase shares (other than an option listed on a prescribed stock exchange) at a price that may differ from their fair market value at the time of their acquisition. The amendment to this subsection clarifies that these provisions do not apply where the agreement is with the corporation whose shares are to be acquired. This amendment is applicable with respect to agreements entered into after December 11, 1979.

Subclause 117(3)

ITA 206(2)(e.1)

Subsection 206(2) of the Act defines the term "foreign property" for purposes of the tax imposed under subsection 206(1). The definition is amended to include property that could be exchanged or converted into foreign property under the terms of any agreement relating to the property or by virtue of the nature of the property itself. This amendment is applicable after November 12, 1981.

Subclauses 117(4) to (6)

These set out the effective dates for the amendments to section 206 of the Act.

Non-Resident Withholding Tax

Clause 118

Section 212 is the principal provision of the Act dealing with the non-resident withholding tax. It enumerates the various payments to non-residents that are subject to this tax. A number of amendments are made to this section of the Act.

Subclauses 118(1) and (2)

ITA
212(1)(b)(ii) and (vi)

Clause 212(1)(b)(ii)(C) of the Act provides an exemption from the non-resident withholding tax for interest paid on certain government or government-guaranteed debt obligations. Under the existing Act, this exemption is scheduled to expire for interest on debt obligations issued after 1982. The amendments to subparagraphs 212(1)(b)(ii) and (vi) extend this exemption for a three-year period to debt obligations issued before 1986.

Subclause 118(3)

ITA
212(1)(b)(vii)

Subparagraph 212(1)(b)(vii) of the Act provides an exemption from non-resident withholding tax in respect of interest paid to arm's length parties on certain long-term corporate indebtedness. Under the existing Act, this exemption is scheduled to expire for interest on debt obligations issued after 1982. The amendment to subparagraph 212(1)(b)(vii) extends this exemption for a three-year period to qualifying debt obligations issued before 1986.

Subclause 118(4)

ITA
212(1)(b)

Paragraph 212(1)(b) of the Act taxes all forms of interest paid or credited by a Canadian resident to a non-resident, subject to specific exemptions from the tax as set out in the subparagraphs thereof. This paragraph is amended, for interest paid or credited after November 12, 1981, by adding new subparagraph 212(1)(b)(ix) which exempts arm's length interest paid by Canadian banks and certain other financial institutions in Canadian currency on Canadian dollar deposits in a branch or office situated outside Canada.

In addition, new concluding words in paragraph 212(1)(b) remove the exemptions reflected in subparagraphs 212(1)(b)(ii) to (vii) and (ix) for interest payable on an obligation entered into after November 12, 1981 (otherwise than pursuant to a commitment in writing made on or before that date) where all or any portion of the interest is contingent or dependent upon the use of or production from property in Canada.

Subclause 118(5)

ITA
212(1)(h)(iii.1)
and (iii.2)

Paragraph 212(1)(h) of the Act imposes the non-resident withholding tax with certain exemptions on payments to non-residents out of pension or superannuation plans. Under the existing law, this tax would apply even in those circumstances where, in the case of a Canadian resident, the payment could be transferred tax-free to a registered pension fund or a registered retirement savings plan. New subparagraph (iii.1) is added, applicable with respect to payments made after 1980, to enable non-residents to make such tax-free transfers. This will allow a non-resident to leave such funds invested in a qualifying deferred income plan in Canada and thereby defer payment of the non-resident withholding tax until the funds are subsequently distributed to him. Payments made 60 days or more after Royal Assent to this Bill may only be transferred on a tax-free basis under this new subparagraph pursuant to an authorization in prescribed form.

Under subparagraph 212(1)(h)(iii) of the existing Act, pension payments that are not included in income by virtue of subsection 81(1) of the Act are exempt from non-resident withholding tax. New subparagraph (iii.2) will continue to provide an exemption from non-resident withholding tax in respect of those pension benefits which were previously exempted under paragraphs 81(1)(a), (h) and (j). This amendment is strictly consequential on the amendments to those paragraphs.

Subclause 118(6)

ITA
212(1)(j)

Paragraph 212(1)(j) of the existing Act imposes non-resident withholding tax on certain allowances and benefits described in subparagraphs 56(1)(a)(ii) to (viii) of the Act. The amendment to this paragraph deletes the references to amounts described in subparagraphs 56(1)(a)(ii) (retiring allowances) and 56(1)(a)(viii) (termination payments). This amendment is consequential on the amendments to the definition of "retiring allowance" which now includes termination payments. Retiring allowances are now subject to tax under the new rules in paragraph 212(1)(j.1).

ITA
212(1)(j.1)

A Canadian resident in receipt of a retiring allowance is entitled within limits to transfer his allowance on a tax-free basis to a registered pension fund or a registered retirement savings plan under paragraph 60(j.1) of the Act. New paragraph 212(1)(j.1), applicable with respect to payments made after 1980, extends this tax-free transfer to non-residents. Retiring allowances paid 60 days or more after Royal Assent to this Bill may only be transferred on a tax-free basis under this paragraph pursuant to an authorization in prescribed form.

Subclause 118(7)

ITA
212(1)(l)

Paragraph 212(1)(l) of the existing Act imposes the non-resident withholding tax on payments out of a registered retirement savings plan ("RRSP") that would be taxable if the payment were received by a Canadian resident. Thus, the non-resident withholding tax would apply even in those circumstances where, in the case of a Canadian resident, the payment could be transferred on a tax-free basis to another RRSP or under paragraph 60(l) of the Act to acquire an annuity contract. The amendment to paragraph 212(1)(l) extends the same right to defer tax to non-residents. The subsequent payments out of the RRSP or under the paragraph 60(l) annuity will attract the non-resident withholding tax.

ITA 212(1)(m)

Paragraph 212(1)(m) of the Act imposes the non-resident withholding tax on payments out of a deferred profit sharing plan. This tax applies even in those circumstances where, in the case of a Canadian resident, the payment could be transferred on a tax-free basis to a registered pension fund or an RRSP under paragraph 60(j) of the Act. The amendment to paragraph 212(1)(m) extends the ability to make such tax-free transfers to non-residents.

These amendments apply to payments made after 1980 except that the requirements for authorizations in prescribed form will not apply until 60 days after Royal Assent to the Bill.

Subclause 118(8)

ITA 212(1)(o)

Paragraph 212(1)(o) of the Act provides for non-resident withholding tax on annuity payments not otherwise referred to in subsection 212(1). The amendment to this paragraph, applicable with respect to amounts paid or credited after November 12, 1981, exempts from non-resident withholding tax payments in respect of an annuity issued in the course of carrying on a life insurance business outside Canada.

Subclause 118(9)

ITA 212(2)(b.1)

Subsection 212(2) of the Act imposes the non-resident withholding tax on dividends paid to non-residents by a corporation resident in Canada. This amendment to subsection 212(2) provides that "life insurance capital dividends" paid or credited after June 28, 1982 are subject to non-resident withholding tax. This amendment is consequential on new paragraph 89(1)(b.2) of the Act which creates a "life insurance capital dividend account" in respect of certain life insurance proceeds received by a corporation. An explanation of this new account is contained in the commentaries on subsections 83(2.1) and 89(1) of the Act.

Subclause 118(10)

ITA 212(3)

This subclause repeals subsecton 212(3) of the Act. As a result, the five-percentage-point reduction in the rate of the non-resident witholding tax on dividends paid by a corporation having a "degree of Canadian ownership" does not generally apply to dividends paid after November 12, 1981.

Subclause 118(11)

ITA 212(11.1) and (11.2)

A trust resident in Canada is subject to tax under Part I of the Act as an individual on its world income. Subsection 212(11) of the Act provides that the gross amounts paid or credited by the trust to a non-resident beneficiary as income are subject to non-resident witholding tax. The trust, however, may not obtain a deduction from its taxable income in respect of all of the amounts that are paid or credited by it to a non-resident beneficiary. For example, the income of a trust that would, if earned directly by the non-resident, be taxable under Part I of the Act, is subject to tax as income of the trust even though these amounts may be payable under the terms of the trust to a non-resident beneficiary.

Subsection 212(11.1) of the Act has been amended and a new subsection 212(11.2) introduced to eliminate any double taxation that would otherwise arise in these circumstances. They provide an exemption from the non-resident withholding tax, effective after November 12, 1981, for the portion of amounts paid or credited to non-resident beneficiaries that is not allowed as a deduction to the trust and is designated by the trustee. This ensures that those amounts that are subject to tax in the trust under Part I will not be subject to non-resident withholding tax.

Subclause 118(12)

ITA
212(13)(d)

Subsection 212(13) of the Act imposes non-resident withholding tax on certain payments made by one non-resident to another non-resident where the amount paid is deductible in computing the taxable income of the payor earned in Canada. Paragraph 212(13)(d) is amended, effective for payments in respect of terminations of employment after November 12, 1981, to delete the reference to termination payments. These payments are now included in the definition of "retiring allowance" in subsection 248(1) of the Act, as amended.

Subclauses 118(13) to (23)

These set out the effective dates for the amendments to section 212 of the Act.

Election Respecting Certain Payments to Non-Residents

ITA
217(b)(iii)

Clause 119

Section 217 of the Act provides that a non-resident may elect to file a Canadian tax return and pay tax at graduated rates under Part I of the Act rather than pay the flat-rate non-resident withholding tax on certain pension and other similar payments. Where the election is made, these payments will be added to the non-resident's taxable income earned in Canada as determined under subsection 115(1) of the Act. In calculating such taxable income, a non-resident making this election is allowed a deduction for personal exemptions and allowances to which he would have been entitled if he were resident in Canada. The amendment to subparagraph 217(b)(iii) is strictly consequential on the amendments to subsection 115(1) of the Act which limit certain of the deductions available to non-residents. Non-resident pensioners and others to whom section 217 applies will continue to be allowed to claim the full personal exemptions and allowances for themselves and their dependants as if they were resident in Canada. This amendment is applicable to the 1982 and subsection taxation years.

Clause 120

Subclause 120(1)

ITA
219(5.2)(d)

Under subsection 138(9) of the Act, an insurer, other than a resident insurer not carrying on a life insurance business, segregates certain of its property as being used in its Canadian business and pays tax under Part I of the Act on the income earned from this property. A basic component of this calculation is the insurer's "Canadian investment fund". In general, the larger the fund, the greater the investment income of the insurer subject to tax under Part I.

Subsection 219(4) of the Act allows a non-resident insurer to elect to reduce its Canadian investment fund as of the end of a taxation year. In effect, property is considered to have been removed from its Canadian business operations and the branch tax under section 219 of the Act is levied on the amount of the reduction. However, subsection 219(5.2) of the Act allows the non-resident insurer to elect to defer the branch tax that would otherwise arise, subject to certain restrictions.

Paragraph 219(5.2)(d) is amended, applicable after December 11, 1979, to provide that the election to defer the branch tax that would otherwise arise where a non-resident insurer reduces its Canadian investment fund will be available only where an election under subsection 219(4) has been made.

Subclauses 120(2) and (3)

ITA
219(8)(a)(ii) and (b)(ii)

A non-resident insurer may, under subsection 219(5.2) of the Act, elect jointly with a "qualified related corporation" to defer the branch tax imposed under section 219 of the Act that would otherwise arise where the non-resident insurer ceases to carry on its insurance business in Canada or elects to reduce its Canadian investment fund. The expression "qualified related corporation" is defined in subsection 219(8) as a corporation resident in Canada that is related to the non-resident insurer in the manner defined therein and that carries on an insurance business in Canada or owns all the issued and outstanding shares of a corporation resident in Canada that carries on an insurance business in Canada. Subparagraphs 219(8)(a)(ii) and (b)(ii) of the Act are amended to provide an exception for directors' qualifying shares from the requirement that a corporation own all the issued and outstanding shares of a corporation in order to be a qualified related corporation.

Subclause 120(4)

This sets out the effective date for the amendments to section 219 of the Act.

Garnishment

Clause 121

Subclause 121(1)

ITA
224(1) and (1.1)

Section 224 of the Act permits the Minister of National Revenue to collect amounts owing under the Act by a taxpayer by providing that any person who is or will be liable to make a payment to the taxpayer, or any person described in subsection 224(1.1) of the Act who intends to loan or advance moneys to or make a payment on behalf of the taxpayer, may be required to pay the amount to the Receiver General of Canada on account of the taxpayer's liability. This collection procedure is called garnishment.

Subsection 224(1) of the Act permits the garnishment of any amount that a person is liable to pay to the taxpayer. Subsection 224(1) is amended, effective on Royal Assent to the Bill, to provide that the Minister may issue a garnishment order where he has knowledge or suspects that a person is or will, within 90 days, be liable to make a payment to the taxpayer.

Subsection 224(1.1) of the Act permits a garnishment order where the Minister has knowledge or suspects that a person described therein will loan or advance moneys to or make a payment on behalf of the taxpayer. This subsection is amended, effective on Royal Assent to the Bill, to provide that a garnishment order may be issued up to 90 days before the time that the loan, advance or payment will be made and to extend the application of this subsection to any person by whom the taxpayer is, or will be within 90 days, employed or engaged to provide services and to any corporation that does not deal at arm's length with the taxpayer. Subsection 224(1.1) previously permitted the Minister to issue garnishment orders in respect of such loans, advances or payments only to financial institutions.

Subclause 121(2)

ITA
224(4.1)

Subsection 224(4.1) of the Act is amended, effective on Royal Assent to the Bill, to provide that any person who fails to comply with a garnishment order issued under subsection 224(1.1) is liable to pay an amount equal to the lesser of the amount the person was required to pay under that subsection and the amount of money actually loaned, advanced or paid. This amendment is consequential on the amendment to subsection 224(1.1).

Acquisition of Debtor's Property

Clause 122

ITA 224.2

New section 224.2 of the Act, effective on Royal Assent to the Bill, allows the Minister of National Revenue to acquire and dispose of any interest in a taxpayer's property that he is given a right to acquire in legal proceedings, under a court order or through sale or redemption. This enables the Minister to participate fully in foreclosures and other similar proceedings for the purpose of collecting debts owed by the taxpayer under the Act or under those provincial taxation statutes that he administers.

ITA 224.3

New subsection 224.3(1) of the Act enables the Minister of National Revenue to issue a garnishment order in cases where moneys have been seized from the taxpayer by the police in the course of administering or enforcing the criminal law of Canada under circumstances where the moneys may be restored to the taxpayer. Such an order could not technically be made in the absence of this provision due to the absence of a debtor-creditor relationship between the police and the taxpayer. Subsection 224.3(2) provides that a receipt issued by the Minister will discharge the police from the requirement to return the seized money to the debtor.

Clause 123

Subclause 123(1)

ITA 227(9)(b)

Paragraph 227(9)(b) of the Act is amended, effective on Royal Assent to the Bill, to provide that a person who has failed to pay an amount of tax that he is required to pay under section 116 of the Act or a Regulation made under subsection 215(4) of the Act is liable to pay a penalty, in addition to the amount plus interest thereon. This amendment expands the previous reference to subsection 116(5) and is consequential on the addition of subsection 116(5.3) to the Act.

Subclause 123(2)

ITA 227(10)

Subsection 227(10) of the Act provides that the general procedures of assessment, objection and appeal contained in Divisions I and J of Part I of the Act apply to certain amounts payable under the Act. The amendments to this provision are consequential on the addition of two new sections to the Act—section 227.1, which provides for the liability of a corporation's directors in certain circumstances, and section 234.1, which provides a penalty on air carriers who fail to file the necessary certificate for aviation turbine fuel purchased in Canada for use on certain international flights. This amendment is applicable after November 12, 1981.

Subclause 123(3)

This sets out the effective date for the amendment to subsection 227(10) of the Act.

Liability of Directors

Clause 124

ITA 227.1

Section 227.1 of the Act has been added to make the directors of a corporation jointly and severally liable in specified circumstances for the withholding tax obligations imposed on the corporation under sections 135, 153 or 215 of the Act. The liability is imposed on persons who were directors at the time the corporation failed to deduct or withhold or remit the required tax. The liability also extends to any related interest or penalty.

Directors will be liable in the following circumstances:

- where a certificate in respect of the corporation's liability has been registered in the Federal Court and execution is returned unsatisfied in whole or in part, in which case liability is limited to the amount unpaid by the corporation after taking into account the amounts recovered under the execution order;
- where a claim has been proved in respect of the liability within six months after the earliest of the date on which the corporation commenced liquidation or dissolution proceedings or was dissolved; or
- where the corporation has made an assignment in bankruptcy or has been put into receivership and the claim is proved within six months of such event.

A director who has satisfied a claim under this section is entitled to contribution from the other directors who were liable for the claim. He is also entitled to any preference that Her Majesty in right of Canada would have had if the amount had remained unpaid where the amount has been proved in liquidation, dissolution or bankruptcy proceedings undertaken on behalf of the corporation.

A director is not liable under this section where he exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. In addition, a director is not liable if proceedings are commenced more than two years after he ceased to be a director.

Section 227.1 is applicable with respect to amounts required to be deducted or withheld and remitted to the Receiver General after November 12, 1981.

Aviation Turbine Fuel

Clause 125

ITA 234.1

Section 234.1 has been added to the Act to provide for a penalty of $100 per cubic metre when an air carrier resident in Canada purchases aviation turbine fuel after January 31, 1982 for use on an international flight and has failed to file a fuel certificate in prescribed form. The expression "international flight" is defined to exclude any flight of an aircraft having a maximum take-off weight not exceeding 34,000 kilograms.

Where the required fuel certificate is provided, the seller of the aviation turbine fuel is required to include a special additional amount in income as provided for in paragraph 69(7.1)(b) of the Act. The certificate procedure introduced in section 234.1 is designed to ensure that information necessary for the purposes of the special inclusion under that paragraph is provided by the airlines.

Communication of Information

Clause 126

Section 241 of the Act prohibits the communication of, or access to, information or documents obtained for the purposes of either the *Income Tax Act* or the *Petroleum and Gas Revenue Tax Act* except in the circumstances specifically enumerated therein.

Subclause 126(1)

ITA 241(4)(f)

Paragraph 241(4)(f) of the existing Act provides that information obtained under the Act may be communicated to, or access to documents may be obtained by, officials of the Departments of Finance and National Revenue, Customs and Excise for certain purposes. The amendment to this paragraph extends the authority to communicate information to officials of the Department of Energy, Mines and Resources or to a provincial government for the purpose of administering or enforcing the federal and Alberta Petroleum Incentives Programs.

Subclause 126(2)

ITA 241(4)(g)

Paragraph 241(4)(g) has been added to the Act to allow information regarding the name, address, occupation or type of business of a taxpayer to be communicated to federal or provincial government departments or agencies for the purpose of enabling such entities to obtain statistical data for research and analysis.

ITA 241(4)(h)

New paragraph 241(4)(h) allows information to be communicated to the Canada Employment and Immigration Commission or the Department of Employment and Immigration for the purposes of administering, evaluating or enforcing the *Unemployment Insurance Act, 1971* or other prescribed employment program.

These amendments become effective when the Bill receives Royal Assent.

Revenue Canada Logo

Clause 127

ITA 244(13.1)

The addition of subsection 224(13.1) to the Act provides that, after November 12, 1981, the words "Revenue Canada-Taxation" or "Revenu Canada (Impôt)" appearing on any document issued in connection with the administration or enforcement of the Act are deemed to be a reference to the "Department of National Revenue" and "ministère du Revenu national".

General Definitions

Clause 128

ITA 248(1)

Section 248 of the Act defines many of the terms used in the Act.

Subclause 128(1)

"Amount"

The amendment to the definition "amount" is consequential on the addition of new subsection 112(2.3) to the Act relating to short-term preferred shares. The amendment adds the reference to subsection 112(2.3) in the context of determining the amount of a stock dividend. Thus, the amount of a stock dividend paid by a corporation on an arm's length short-term preferred share will be the amount of the resultant increase in the corporation's paid-up capital only if that increase is greater than the fair market value of the stock dividend at the time of payment. This amendment is applicable after November 12, 1981.

Subclause 128(2)

"Gross Revenue"

The definition "gross revenue" is amended, for the 1983 and subsequent taxation years, to include all amounts that must be included in income under subsections 12(4) or (8) or section 12.2. Subsections 12(4) and (8) of the Act require the inclusion in income of accrued interest on certain debt obligations. Section 12.2 of the Act requires an inclusion of accrued income on certain life insurance policies and annuity contracts. These provisions are explained more fully in the commentaries on sections 12 and 12.2 of the Act.

Subclauses 128(3), (4), (5) and (6)

"Income Bond" or "Income Debenture"

The first amendment to the definition "income bond" or "income debenture" is simply to remove the words "par la corporation" which immediately preceded paragraph (a) in the French version. The words "by the corporation" had previously been deleted from the English version.

The amendment to paragraph (c) of this definition clarifies that a debt obligation of a corporation not resident in Canada cannot qualify as an income bond or income debenture.

A further amendment to this definition provides that where a corporation in financial difficulty issues an income bond or income debenture after November 12, 1981, the use of the proceeds must be used in the financing of a business carried on in Canada.

An "income bond" or "income debenture" is a bond or debenture of a corporation on which interest or dividends are payable only to the extent that the corporation has made a profit and in respect of which paragraph (a), (b), or (c) of the definition applies. Paragraphs (a) and (b) include a bond or debenture issued before November 17, 1978, or after November 16, 1978 and before 1980 pursuant to an agreement in writing to do so made before November 17, 1978. Such an agreement is referred to as an "established agreement". Paragraph (c) of the definition includes a bond or debenture issued for a term not exceeding five years by a corporation resident in Canada that is in financial difficulty. As a result of the addition of subparagraph (e)(v), a bond or debenture (other than one described in paragraph (c)), acquired at any time after November 12, 1981 by one financial institution from another, which is subject to or conditional on a "guarantee agreement", will be considered to have been issued at that time and not pursuant to an established agreement.

Subclause 128(7)

"Life Insurance Capital Dividend"

The addition of the definition "life insurance capital dividend" ensures that the definition as set out in subsection 83(2.1) of the Act applies wherever that expression is used in the Act.

Subclause 128(8)

"Prescribed"

The definition "prescribed" is amended to provide authority to set out in the Income Tax Regulations either a rate of interest or the formula by which the prescribed rate of interest is determined. This amendment is consequential on the change from an annual to a quarterly adjustment of the interest rate charged on tax arrears and paid on tax over-payments. Since January 1982, the prescribed interest rate has been determined every three months by reference to the average interest rate on 90-day Treasury bills during the first month of the preceding quarter. This amendment is effective on Royal Assent to the Bill.

Subclause 128(9)

"Property"

The amendment to the definition "property" is consequential on the amendments to sections 10 and 34 of the Act relating to professional work in progress. The amended definition ensures that the work in progress of a business that is a profession is property and will therefore fall within the rules in section 10 relating to inventory. This amendment is applicable to the 1982 and subsequent taxation years.

Subclause 128(10)

"Retiring Allowance"

The amendment to the definition "retiring allowance" is consequential on the changes in the tax treatment of damages for wrongful dismissal and other similar amounts that were previously included in the definition of termination payments. The amendment treats as a retiring allowance the full amount of any payment to an employee received as damages or pursuant to a judicial determination. The amendment excludes from the definition any amount received from an employer on the death of an employee. The amendment is applicable with respect to amounts received in respect of any termination of an office or employment after November 12, 1981.

Subclause 128(11)

"Short-Term Preferred Share"

This amendment adds the definition "short-term preferred share" to subsection 248(1). Under subsection 112(2.3) of the Act, a dividend received by a corporation on a short-term preferred share is not deductible in computing its taxable income.

Under paragraph (a) of the definition, a share will be a short-term preferred share if the share was issued by a corporation after November 12, 1981 and:

(i) the corporation or any member of the "issuing group" to which it belongs is or may be required to redeem, acquire or cancel the share or reduce its paid-up capital at any time within 18 months from the date of its issue, and

(ii) the share was issued in order to obtain funds for a member of the issuing group and the share may reasonably be regarded as having been issued in lieu of commercial paper or a similar short-term debt instrument that would otherwise have been issued or sold on the money market had a member borrowed the funds.

For the purposes of these provisions, an "issuing group" to which a corporation belongs means the corporation itself, any person related to it and any partnership or trust of which it or a related person is a member or beneficiary.

Under paragraph (b) of the definition, if a share was issued to obtain funds as described in (ii) above and is convertible within 18 months from the date of its issue into debt or into another short-term preferred share, that share may also constitute a short-term preferred share.

Paragraphs (c) to (e) of the definition provide exceptions from the definition for a share issued before 1983 pursuant to an agreement to do so made before November 13, 1981, a share issued in a financial difficulty situation as described in paragraph (e) of the definition "term preferred share", and a prescribed share. (Section 6201 of the draft Income Tax Regulations, published on June 28, 1982, proposed to prescribe minor holdings of publicly-traded shares for the purposes of subsection 112(2.3) of the Act. Since the scope of subsection 112(2.3) as proposed in the draft legislation of June 28, 1982 has been narrowed, the exemption for short-term preferred shares in the draft Income Tax Regulations will not be proceeded with for shares issued after 1982.)

Paragraphs (f) to (l) of the definition provide a number of supplementary rules.

The definition of a short-term preferred share applies only where the share was issued after November 12, 1981. When the terms or conditions relating to repayment of a share issued before November 13, 1981 are changed, paragraph (f) treats the share as having been issued at the time of the modification. This is to prevent the use of a share that was issued before November 13, 1981 to circumvent the rules.

Where a person has an interest in a trust through another trust, the person is deemed to be a beneficiary of the first-mentioned trust by paragraph (g) of the definition. This ensures the ability to "look through" an artificial arrangement intended to obscure the identity of a beneficiary of a trust.

Paragraph (h) anticipates the possibility that a share with unusual characteristics (for example, one with a very low paid-up capital in relation to a relatively high stipulated dividend rate) might be issued jointly with a debt obligation or a short-term preferred share (with a very low or nil interest or dividend rate) in order to circumvent the provisions of subsection 112(2.3). Where one of the main purposes of the issue of such a share is to avoid or limit the application of subsection 112(2.3), this paragraph treats it as a short-term preferred share.

Where a short-term preferred share is exchanged as a result of an amalgamation or a capital reorganization, paragraph (i) ensures that the new share retains the character of the old share.

Paragraph (j) treats a share as being redeemable within 18 months of issue if, after June 28, 1982, the terms of the share are established or modified so that it is reasonable to expect that the share will be redeemed within 18 months of its date of issue. This might apply, for example, in the case of a redeemable share issued for an indefinite term but on which the rate is scheduled to increase sharply after one year.

Paragraph (k) also treats a share as being redeemable within 18 months in circumstances where the issuing corporation will dissolve or wind up within 18 months from the date the share was issued.

Paragraph (l) applies to a share issued by one member of an issuing group to another member in circumstances where the share is subsequently sold in an arm's length sale. In this situation, the share is deemed to have been issued at the time of the subsequent sale.

The new definition of short-term preferred share applies after November 12, 1981.

Subclause 128(12)

"Small Business Bond" and "Small Business Development Bond"

Subsection 248(1) is amended to add the definitions "small business development bond" and "small business bond". These expressions are defined in sections 15.1 and 15.2 of the Act. The definitions are included in section 248 to ensure that they have general application throughout the Act.

Subclause 128(13)

"Termination Payment"

The definition "termination payment" is repealed for any termination of an office or employment after November 12, 1981. Subparagraph 56(1)(a)(viii) of the Act, which included a termination payment in income, is also repealed. Receipts that were previously included in the calculation of termination payments are now included in income as retiring allowances.

Before the repeal of this definition, a termination payment was defined generally as the amounts received in respect of a termination of an office or employment, to a maximum 50% of the taxpayer's income from that office or employment for the preceding 12 months. This meant that an amount, not exceeding 50% of the taxpayer's annual remuneration from the office or employment, received in respect of the termination and not otherwise taxable was included in income. The amendment of the definition "retiring allowance", coupled with the repeal of the definition "termination payment", means that the full amount of all payments in respect of a termination will be included in income.

Subclause 128(14)

"Term Preferred Share"

This subclause amends the definition "term preferred share". Under subsection 112(2.1) of the Act, dividends received by a specified financial institution on a term preferred share acquired in the ordinary course of its business are not deductible in computing its taxable income. In general, a term preferred share is a share issued after November 16, 1978 which can reasonably be regarded as a debt substitute. The changes to the definition "term preferred share" are outlined below.

(1) The preamble to the definition has been amended and, as a result, a share will be a term preferred share if the share is issued or acquired after June 28, 1982 and, at the time of the issuance or acquisition, there was an arrangement to dissolve or wind up the issuer at a particular time.

(2) Subparagraph (a)(i) of the definition is amended to remove the 10-year exception for shares issued after November 12, 1981. As a result, a share issued after that date will be a term preferred share if the owner of the share can cause its redemption at any time.

(3) Subparagraph (a)(ii) of the definition is amended to remove the 10-year exception and the 5% sinking fund exception for shares issued after November 12, 1981. Any share issued after that date will be a term preferred share if the issuer or any other person is required to redeem or acquire the share at any time.

(4) Subparagraph (b)(iii) is amended to clarify that it applies to a corporation that acquired a share after December 11, 1979 and is associated with any corporation described in subparagraph (b)(i) or (ii) of the definition.

(5) Paragraph (e) of the definition provides the exception for a share issued by a corporation in financial difficulty. This paragraph is

amended to reduce the term of a share described therein from 10 years to 5 years and to provide that the proceeds of the issue must be used in the financing of the business of the corporation carried on in Canada. These changes apply to shares issued after November 12, 1981.

(6) Subparagraph (h) sets out various circumstances in which a share is deemed to have been issued at a time other than its actual date of issue. These circumstances may arise on the earliest date that a share is repayable, when the terms or conditions of the share relating to its repayment are modified or a share is acquired by a specified financial institution or certain other entities.

(7) Paragraphs (i) and (j) are new provisions applicable after June 28, 1982 and December 31, 1982, respectively. These provisions are similar to paragraphs (h) and (j) of the definition "short-term preferred share" which are described in the commentary thereon.

(8) The concluding words of the definition "term preferred share" are new and are similar to the wording in paragraph (g) of the definition "short-term preferred share" which is discussed in the commentary thereon.

Subclause 128(15)

ITA 248(6)

Statutes such as the *Canada Business Corporations Act* enable a corporation to issue a class of shares in series so that one class may be divided into two or more series. There is no existing provision of general application in the Act recognizing this practice. As a result, it was not clear, where a class had been issued in series, whether each series would itself be regarded as a separate class. This question would arise, for example, in computing "paid-up capital" as defined in paragraph 89(1)(c) of the Act. Subsection 248(6) has been added to the Act, effective after November 12, 1981, and provides that where a corporation has issued shares of a class in two or more series, each series will be regarded as a separate class.

Subclauses 128(16) to (24)

These set out the effective dates for the amendments to section 248 of the Act.

Arm's length

Clause 129

ITA
251(3.1)

Section 251 of the Act provides rules for determining whether or not persons deal with each other at arm's length. New subsection 251(3.1) is added, applicable after November 12, 1981, to treat an amalgamated corporation as being related to a predecessor corporation where they would have been related immediately before the amalgamation had the amalgamated corporation been in existence at that time with the same shareholders as after the amalgamation. In this case, the corporations will be considered not to have dealt with each other at arm's length even though they were not in existence at the same time.

Meaning of "Spouse" and "Former Spouse"

Clause 130

ITA 252(3)

This amendment, applicable after 1981, adds new subsection 252(3) to the Act which provides that, for the purposes of certain specified provisions of the Act, the terms "spouse" and "former spouse" include a person whose marriage is void or voidable. The provisions referred to in the new subsection relate to the payment and receipt of alimony and maintenance, the transfer of amounts in a taxpayer's registered retirement savings plan to another registered retirement savings plan under which he, his spouse or his former spouse is the annuitant, and the *inter vivos* transfer of property to certain persons, including a spouse or former spouse. Subsection 73(1.2), which is repealed by this Bill, provided this extended meaning, but only for the purpose of subsection 73(1) which deals with *inter vivos* transfers of property.

Acquisition of Control

Clause 131

Subclauses 131(1) and (2)

Subsection 256(7) of the Act provides rules for determining whether or not there has been an acquisition of control of a corporation for the purposes of certain provisions of the Act.

ITA 256(7)

The preamble of subsection 256(7) of the Act is amended to add a reference to new subsection 66(11.1) and to replace the former references to subsections 111(4) and (5) with a reference to section 111. These amendments are consequential on the addition of subsection 66(11.1) and new subsections 111(5.1), (5.2) and (5.3) to the Act.

ITA 256(7)(b)

Paragraph 256(7)(b) of the Act provides that where, immediately after an amalgamation, the person or group of persons who controlled the new corporation did not control a particular predecessor corporation immediately before the amalgamation, that person or group of persons will be treated as having acquired control of the predecessor corporation immediately before the amalgamation. This rule is relevant for the purposes of the carry-forward into a newly amalgamated corporation of non-capital losses and net capital losses of a predecessor corporation pursuant to subsection 87(2.1) and section 111, and for the deductibility of exploration and development expenses of a predecessor corporation pursuant to subsections 66(11) and (11.1) of the Act.

The amendment to paragraph 256(7)(b) ensures that, on the amalgamation of two or more predecessor corporations which were controlled by related persons prior to the amalgamation, the rules provided in paragraph 256(7)(a) of the Act will apply so that the control of the predecessor corporations will not be treated as having changed.

These amendments are applicable after November 12, 1981.

Subclause 131(3)

ITA 256(8)

Subsection 256(8) of the Act is an anti-avoidance provision. It applies where a taxpayer has an option to acquire shares of a corporation or to control the voting rights of shares and one of the main purposes in acquiring the option was to avoid the limitations on the deduction of the net capital or non-capital losses under section 111 or on the deduction of exploration and development expenses under section 66 where there has been a change of control of the corporation. In these circumstances, the taxpayer is deemed to have acquired the shares to which the option relates.

Subsection 256(8) is amended to add references to subsections 66(11.1), 111(5.1) and 111(5.2). These amendments are consequential on the amendments to sections 66 and 111. Subsection 256(8) is also amended to clarify that the right referred to in the opening words of the provision is a right "with respect to shares". These amendments apply to taxation years ending after November 12, 1981.

Subclauses 131(4) and (5)

These set out the effective dates for the amendments to section 256 of the Act.

Degree of Canadian Ownership

Clause 132

ITA
257

Section 257 of the Act is repealed. It provided rules for determining whether a corporation had a degree of Canadian ownership. The withholding tax on dividends paid by a corporation having a degree of Canadian ownership to a non-resident shareholder was previously reduced under subsection 212(3) by five percentage points. The rate was thus reduced from 25% to 20% on dividends paid to residents of non-treaty countries, and generally from 15% to 10% on dividends paid to most countries with which Canada had concluded a double taxation agreement or convention. This special reduction in the rate of withholding tax ceased to apply after November 12, 1981 and section 257 is therefore no longer required for that purpose. The definitions contained therein which are necessary for Part X purposes have been added to section 204 of the Act.

Capital Properties Held on December 31, 1971

Clause 133

Subclauses 133(1) and (2)

ITAR
26(3)(c)(iv)
26(5)(c)(ii)(A)

Subsection 26(3) of the *Income Tax Application Rules, 1971* sets out the method of computing the adjusted cost base of certain capital property held on December 31, 1971 by corporations and by those individuals who have not elected to establish the Valuation Day ("V-day") value as their cost. Under this provision, the tax cost is deemed to be the median of actual cost, V-day value and adjusted proceeds of disposition.

The effect of this rule is to ensure that whenever the proceeds of disposition of the property fall in the range between actual cost of the property and its V-day value, no gain or loss will arise. For the purpose of this median rule, the proceeds are required to be recast so as to add back or deduct amounts that are considered to be received or paid on account of capital and that were accordingly reflected in the adjustments to cost in determining the adjusted cost base of the property. As recast, the proceeds can then properly be compared with V-day value and cost.

Subsection 26(5) of the Rules provides a similar rule where property originally owned before 1972 and that was subject to the median rule has been transferred through one or more non-arm's length transactions or events. Among other things, this rule requires that certain cost base adjustments and gains and losses of previous owners be recognized in determining the new owner's tax cost.

The amendments to subparagraph 26(3)(c)(iv) and clause 26(5)(c)(ii)(A) modify the computations of adjusted proceeds and of tax cost under the median rule in respect of certain disallowed losses arising from dispositions occurring after November 12, 1981. These amendments ensure that proceeds are properly recast for the purposes of subsection 26(3) and that the above-noted losses are not double-counted in determining the adjusted cost base of certain property.

Subclause 133(3)

ITAR
26(9.4)(b)

Paragraph 26(9.4)(b) of the Rules specifies rules for determining the adjusted cost base of a partnership interest acquired before 1972. It is designed to ensure the proper measurement of capital gains or losses on the disposition of such a partnership interest. The amendment generally conforms these rules to the similar rules relating to partnership interests contained in clause 53(2)(c)(i)(B) of the Act. As was the case with the amendment to that clause proposed in the 1980 Budget, the amendment is applicable in determining the adjusted cost base of a partnership interest after October 28, 1980 or, where a person has elected before 1982, in determining the adjusted cost base of a partnership interest disposed of by him after 1976 and before October 29, 1980.

Subclause 133(4)

ITAR 26(17.1)

New subsection 26(17.1) of the Rules is consequential on the amendment contained in subsection 138(11.3) of the Act which treats fair market value as the proceeds of disposition of certain property held by life insurance companies where there is a change in use of the property. This new subsection ensures that the transitional rules relating to the determination of tax cost and, therefore adjusted cost base, will not apply with respect to any subsequent disposition or deemed disposition of such property. The amendment is applicable to taxation years commencing after November 12, 1981.

Subclauses 133(5) to (7)

These set out the effective dates for the amendments to section 26 of the Rules.

Old Age Security Act

Clause 134

This clause adds new paragraph 11(d) to the *Old Age Security Act*. The amendment is consequential on the changes to the *Income Tax Act* which include social assistance payments in income and allow them as a deduction in computing taxable income. This change to the *Old Age Security Act* ensures that social assistance payments are not included in determining the eligibility of an individual to receive income-tested benefits under that legislation.